IDEAS ON LIBERTY

- The Market for Market Space
- 150 Years and Still Dismal!
- Stealing from ATM Machines
- Does Insanity "Cause" Crime?

MARCH 2000

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

FEE Regional Seminars

FEE's regional seminars are a great way to learn more about free markets and free societies and meet others in your area interested in promoting these ideas. Hear expert speakers discuss economics, politics, philosophy and history at one of our selected events throughout the United States.

2000 Programs

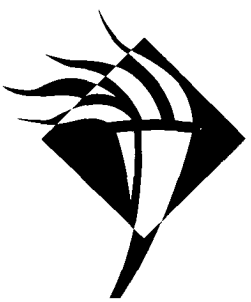
April 8 - St. Pete Beach, FL

April 22 - White River Junction, VT

July 6-8 - Brookfield Academy (Milwaukee), WI

September 9 - Denver, CO

Look for additional updates in *Ideas on Liberty* and on FEE's website, www.fee.org.



For more information, please contact Meredith Kapushion: seminars@fee.org

Foundation for Economic Education
30 South Broadway
Irvington-on-Hudson, NY 10533

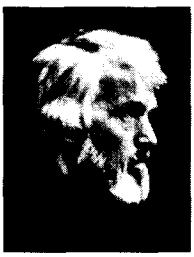
(914) 591-7230 (914) 591-8910 Fax

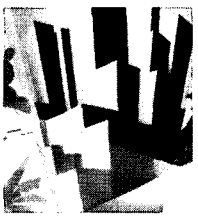
LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY

March 2000 Vol. 50, No. 3

FEATURES





8 **150 Years and Still Dismal!** *by David M. Levy*

11 **The Irresistible Force of Market Competition** *by Israel M. Kirzner*

17 **The Myth of the Social Security "Trust Fund"** *by John Attarian*

22 **In Defense of Grocery Coupons** *by Bill Field*

24 **The Market for Space in the Market** *by Gary M. Galles*

28 **Spam, Spam, Spam, and Spam** *by Gary McGath*

33 **The Stakeholder Fallacy** *by Norman Barry*

37 **Regulatory Extortion** *by Thomas J. DiLorenzo*

45 **Sources of Pro-Union Sentimentality** *by Charles W. Baird*

48 **The Day We Read No More** *by Angus E. Crane*

COLUMNS

4 *THOUGHTS on FREEDOM*—**Moderation in All Things** *by Donald J. Boudreaux*

15 *IDEAS and CONSEQUENCES*—**Hospital Food and Socialized Medicine** *by Lawrence W. Reed*

26 *POTOMAC PRINCIPLES*—**Stealing from ATM Machines** *by Doug Bandow*

31 *THE THERAPEUTIC STATE*—**Does Insanity "Cause" Crime?** *by Thomas Szasz*

43 *ECONOMIC NOTIONS*—**The Hidden Cost of Taxation** *by Dwight R. Lee*

51 *ECONOMICS on TRIAL*—**Will the Savings Crisis Lead to Stagnation?** *by Mark Skousen*

63 *THE PURSUIT of HAPPINESS*—**They Can Afford It, Can't They?** *by Russell Roberts*

DEPARTMENTS

2 **Perspective–Humble Hubris** *by Sheldon Richman*

6 **More "Public Investment" Needed? It Just Ain't So!** *by David Boaz*

54 **Capital Letters**

56 **Book Reviews**

Financing College Tuition: Government Policies and Educational Priorities, edited by Marvin H. Kosters, reviewed by George C. Leef; **The Right to Home School: A Guide to the Law on Parents' Rights in Education** by Christopher J. Klicka, reviewed by Karen Y. Palasek; ***The Fountainhead:* An American Novel** by Douglas J. Den Uyl, reviewed by Tibor R. Machan; **Alternate Route: Toward Efficient Urban Transportation** by Clifford Winston and Chad Shirley, reviewed by John Semmens; **Guilt, Blame, and Politics** by Allan Levite, reviewed by James A. Woehlke; **The Third Way: The Renewal of Social Democracy** by Anthony Giddens, reviewed by Antony Flew.

Lesson plans for articles are available at www.fee.org.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY

Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533
Phone (914) 591–7230 FAX (914) 591–8910
E-mail: iol@fee.org
FEE Home Page: http://www.fee.org

President: Donald J. Boudreaux

Editor: Sheldon Richman

Managing Editor: Beth A. Hoffman

Editor Emeritus
Paul L. Poirot

Book Review Editor
George C. Leef

Editorial Assistant
Mary Ann Murphy

Columnists
Charles W. Baird
Doug Bandow
Dwight R. Lee
Lawrence W. Reed
Russell Roberts
Mark Skousen
Thomas Szasz
Walter Williams

Contributing Editors
Peter J. Boettke
Clarence B. Carson
Thomas J. DiLorenzo
Burton W. Folsom, Jr.
Joseph S. Fulda
Bettina Bien Greaves
Robert Higgs
John Hospers
Raymond J. Keating
Daniel B. Klein
Wendy McElroy
Tibor R. Machan
Andrew P. Morriss
Ronald Nash
Edmund A. Opitz
James L. Payne
William H. Peterson
Jane S. Shaw
Richard H. Timberlake
Lawrence H. White

Ideas on Liberty (formerly *The Freeman: Ideas on Liberty*) is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533. FEE, established in 1946 by Leonard E. Read, is a non-political, educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501(c)(3) tax-exempt organization.

Copyright © 2000 by The Foundation for Economic Education. Permission is granted to reprint any article in this issue, provided credit is given and two copies of the reprinted material are sent to FEE.

The costs of Foundation projects and services are met through donations, which are invited in any amount. Donors of $30.00 or more receive a subscription to *Ideas on Liberty*. For delivery outside the United States: $45.00 to Canada; $55.00 to all other countries. Student subscriptions are $10.00 for the nine-month academic year; $5.00 per semester. Additional copies of this issue of *Ideas on Liberty* are $3.00 each.

Bound volumes of *The Freeman* are available from The Foundation for calendar years 1972 to 1998. The magazine is available in microform from *University Microfilms, 300 N. Zeeb Rd., Ann Arbor, MI 48106.*

Cover photo: Gerard Fritz, Weststock.

PERSPECTIVE

Humble Hubris

Al Gore, presidential aspirant and environmental sage, once spoke admiringly of an Indian tribe whose leaders, he said, planned seven generations ahead. His message was clear: if only we shallow, conceited bourgeois Americans had the concern and humility to think like that.

I don't believe there was such a tribe. Anyone who does can't tell the difference between thinking and wishful thinking.

But it is revealing that someone like Al Gore would believe it and revere the tribe. It hardly indicates a humble awareness of man's limits. (That such a tribe, if it did exist, is not around today should surprise no one.)

Anyone who would try to plan seven generations in advance would be either claiming a megalomanic knowledge of the future or presuming to tell his descendants how to live regardless of their preferences. Neither flatters.

The eagerness to believe something so ridiculous illustrates a key difference between the "environmentalist's" and the economist's mindsets. Despite the humble mask, the ideological environmentalist is vain enough to think he knows enough to plan society's future, overriding individual rights in the process. The economist (I have in mind especially the Austrian school) understands that the world is open-ended and that we don't know today what we will learn tomorrow. The environmentalist, sensing no limits to his knowledge, feels justified in shaping and then freezing social development. The economist, understanding the limits of knowledge at any given point, looks to the free market, rooted in private property, for discovery and a multiplicity of individual plans.

The environmentalist will protest that the economist's method leaves society vulnerable to coming disasters. On the contrary, the economist is confident that people are better able to handle disasters if they are wealthy, because wealth permits flexibility of response and resilience. Besides, since our knowledge of the future is always far from complete, we

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

don't know what disaster, if any, is coming. Locking in future generations on the basis of present knowledge is not just arrogant, it is foolhardy.

* * *

Everyone knows that economics was dubbed the "dismal science" in the nineteenth century. But *why* was it dubbed that? David Levy has the shocking answer.

If the law of supply and demand operates as a result of entrepreneurs' efforts to grapple with an uncertain world, and if those efforts generate the rivalrous process known to most people as competition, is there a role for antitrust law to maintain competitive markets? Israel Kirzner renders his verdict, as he continues his series on fundamentals of Austrian economics.

The Social Security Trust Fund is much in the news. Is it being raided? Can it be protected? John Attarian asks—and answers—a more penetrating question: Is there a Trust Fund at all?

If you're stuck in a supermarket checkout line, you may be tempted to think that coupons are costly gimmicks that serve no good purpose. Not so, says Bill Field.

And while we're on the subject of supermarkets, is it unfair for them to charge manufacturers fees for shelf space? Doesn't that harm small companies and the consumers who would enjoy their products? Gary Galles subjects the matter to some economic analysis.

A cost of the age of e-mail is "spam," the electronic equivalent of shady junk mail. But Gary McGath says there's no need to ask the government to rescue those jammed e-mail-boxes, because the marketplace is perfectly capable of handing the problem.

Advocates of government control of business have found a new cause in recent years. They claim that since shareholders are not the only ones with a stake in corporations, the government ought to enforce the firms' obligations to all their "stakeholders." Norman Barry sees some fissures in the argument.

Would officeholders use the government's regulatory power to exact tribute from business? Do turkeys gobble? Thomas DiLorenzo examines this most perverse form of entrepreneurship.

Despite a history marred by violence, labor unions have occupied a special place in the hearts of legislators, judges, and even many regular people. Charles Baird identifies the reason for this and explodes the underlying myths.

When officers of government prohibit citizens from reading, it shouldn't go unnoted. Angus Crane relates an ominous encounter.

Our columnists have found some juicy topics to ruminate on. Donald Boudreaux says there's no escaping tradeoffs. Lawrence Reed looks at a food fight in Manitoba. Doug Bandow and Russell Roberts wonder why ATM fees are a problem. Dwight Lee sees hidden costs in taxation. Thomas Szasz discusses the alleged connection between "insanity" and crime. Mark Skousen sees new respect for savings. And David Boaz, confronting the claim that "public investment" is deficient, responds, "It Just Ain't So!"

This month's reviewers report on books about higher education, homeschooling, Ayn Rand's *The Fountainhead*, transportation, guilt, and the "third way."

—SHELDON RICHMAN

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Thoughts on Freedom

by Donald J. Boudreaux

IDEAS ON LIBERTY
MARCH 2000

Moderation in All Things

Aristotle wisely advised moderation in all things. Gluttons and fanatics self-destruct by refusing to make the tradeoffs necessary to lead a good life. "Don't tell me that I can't drink and carouse every night and not succeed in my career!" insists the fool. "I can have it all."

Well, he can't. No one can.

That's the thing about tradeoffs. They're unavoidable. If you don't make your own tradeoffs, they will be made for you by nature, by chance, or by other people. And it's a sure bet that when you abdicate your ability to choose how your tradeoffs are made, the ways that nature, chance, or other people make them for you will displease you.

As I read it, Aristotle's counsel of moderation is no puritanical call for an austere life unadorned by intense sentiments, pleasures, and passions. Rather, he counsels personal responsibility and rationality in pursuing your sentiments, pleasures, and passions. You simply cannot enjoy limitless amounts of all the possible joys available in life. If you grasp unthinkingly at every pleasurable opportunity that passes your way, you will not be *making* choices. You will be reacting mindlessly. And your mindless pursuit of immediate pleasures will deny you access to other opportunities. You will enjoy fewer pleasures and much less happiness over the long haul than you would have enjoyed had you acted rationally.

Make whatever choices you wish, constrained only by your respect for the rights of others to make whatever choices they wish. But *make* your choices. Make them rationally and wisely. Your choices may differ substantially from mine. But as long as you choose your own tradeoffs rationally—without abdicating that responsibility to others or to fate—your prospects for a fulfilling life are promising.

The Aristotelian counsel of moderation is, thus, a plea to weigh tradeoffs mindfully. It has an important implication for public policy, which is this: true moderation (and its resulting happiness) is necessarily an individual pursuit and accomplishment. It cannot be achieved by a third party, whether that third party is a democratic majority or a dictator. The reason is that, in each instance, striking the right tradeoff requires assessing the relative merits of many different options in light of each person's unique circumstances, opportunities, and aspirations.

Because you cannot know my preferences, hopes, history, and opportunities, and because I cannot know yours, neither of us is well equipped to make sound decisions for the other. Were I to attempt, even with excellent intentions, to make your choices for you, the result would not be moderation for you. The result would be *im*moderation. My inability to know your aspirations and circumstances inevitably would cause me to foist on you too much of some things and to deny you too much of others. Your life would be imbalanced.

Indeed, to the extent that you as an individual are stripped of your right to choose, you are stripped of humanity. Whether you believe

---

Donald Boudreaux is president of FEE.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

that your capacity for rational thought is God-given or the exclusive product of natural selection, the fact is that you possess this capacity. Your capacity to think and to choose is who you are. Exercising it is what makes you an individual. The very concept of individuality is empty absent each person's right to make his own life's choices.

Some readers might respond with an "Of course. Who denies that freedom to choose is necessary both for human happiness and for the flourishing of individuality?" To this response I say: While many people pay lip service to this fact, too few really believe it.

Consider, for example, the demonization over the past several years of tobacco companies. This demonization occurred only because it is widely believed that people are mindless fools who lack sufficient capacity to judge and choose wisely. *If* people so lack the capacity to choose wisely that the mere sight of a cigarette jutting from the chiseled chin of a cowboy impels them to smoke, then a solid case might be made that tobacco companies are predators seizing profit from a fundamental human weakness—namely, an inability to choose and act wisely.

But if most of us truly believe both that people are capable of making their own choices wisely and that people's freedom to choose ought not be throttled, then efforts to demonize tobacco companies would fail. It is today's presumption that smokers are helpless dupes—that people are mere *re*actors rather than actors—that is the source of the current hostility toward smoking and tobacco companies. And it follows almost inevitably from this despairing view of humans-as-foolish-reactors that ordinary men and women must be protected from themselves by the Wise and the Good—or, at least, by those who fancy themselves anointed because they've achieved political power.

Of course, it's true that even the most prudent amongst us sometimes make poor choices. It's also true that some of us persistently react childishly rather than choose wisely. But one of the beauties of a society governed by the impartial rules of private property rights rather than by government dictates is that the consequences—good and bad—that fall on each decision-maker correspond closely to the consequences that these decisions have on others. If I produce a $200 computer that has all of the features and reliability of a model that costs $2,000, I prosper. If, in contrast, I use resources to produce chocolate-covered pickles, I lose money. Likewise, if I use my energy and time to acquire productive skills and knowledge, I prosper. If, in contrast, I squander my energy and time pursuing nothing other than my own immediate gratifications, I personally pay the price.

But when politics replaces freedom and personal responsibility, people who make poor decisions—for example, domestic producers who don't invest as wisely as foreign firms—are often shielded from the consequences of their poor choices. Political favors enable such people to persist in their own immoderation, but only by taxing and regulating the rest of us in ways that compel us to support their immoderate behavior. In the end, society winds up with immoderately large amounts of the undesirable behavior protected by government and too little of the desirable behaviors necessary for a prosperous, free, and civil society.

To have moderation in all things requires freedom from immoderate government. □

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000

More "Public Investment" Needed?

It Just Ain't So!

It must be something in the water. Robert Kuttner is the latest writer from the Boston suburbs to complain that Americans don't spend enough of their hard-earned money on "public investment." In a column that the *Washington Post* titled "Public Parsimony, Private Affluence" (November 29, 1999), Kuttner concluded that "paradoxically, a period of unprecedented private affluence is exactly the right time" to start spending yet more money on government projects.

John Kenneth Galbraith, now an emeritus professor of economics at Harvard University, may have been the first to make this complaint. In his 1958 bestseller, *The Affluent Society*, still a staple of college reading lists, the former World War II economic czar looked around America and proclaimed that he found "private opulence and public squalor." That is, he noticed that privately owned resources were generally clean, efficient, well maintained, and improving in quality, while public spaces were dirty, overcrowded, and unsafe—and he concluded that we ought to move more resources into the public sector.

In 1995 then-Secretary of Labor Robert Reich, formerly a professor at Harvard's Kennedy School of Government, told the graduating class of the University of Maryland not to "secede" from public spaces—that is, not to send their children to private schools, live in gated communities, work in the suburbs, and (gasp!) shop in secure suburban malls.

Now comes Kuttner, a former lecturer at the Kennedy School who now lives in suburban Brookline, to make exactly the same kinds of observations. "We've gotten used to the idea that things public should be vaguely shabby," he complains.

Considering the trillions of dollars spent on government infrastructure since Galbraith made the same point, one begins to wonder whether there's something inherently shabby about government operations. Indeed, no one thinks that government schools, parks, highways, and buildings *should be* shabby, but Kuttner is right to suggest that we've come to expect that they *will be.*

Public versus "Public"

We should briefly note the clever use of the word "public" by advocates of bigger government. When we contrast "public" parks, schools, and so on with "private" spaces, there's always the implication that the "public" spaces are open to us all, while the "private" spaces are closed and exclusive. But of course, most private schools are open to the public, as are most private parks, malls, and transportation systems. The real difference is how they're paid for: "Public" spaces are paid for coercively, through taxation, while "private" spaces are paid for by those who choose to use them or to contribute to their upkeep.

In fact, that's precisely what Kuttner and his allies don't like. They *want* us to be forced to pay for services that will be open to all, and they chafe at the idea that we might choose how to spend our own money or that a generous donor's name might appear on a school, a park, or a public sculpture.

Kuttner says that "civilian public investment is now at the lowest share of gross domestic product in three decades." Of course, with GDP rapidly rising, that lower percentage can still generate more real dollars. But the main reason that taxpayer spending on infrastructure is lower than it was in the 1950s and 1960s in percentage-of-GDP terms is given by John Tatom of the Federal Reserve Bank of St. Louis: "The real capital stock at all levels of government rose from $6,000 per

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

person in 1948 to $10,500 in 1970 and has remained at that level since. The leveling off of infrastructure spending since 1970 is almost entirely attributable to the completion of the interstate highway system and a reduction in spending on school construction as the percentage of the population that is of school age has declined."

Total spending by state and local governments—which do most of the infrastructure spending—has risen (in real terms) from $599 billion in 1970 to $1.4 trillion in 1996. One obvious reason that states don't spend more on infrastructure is that they are spending so much more on things that were previously not the concern of government—housing expenditures up 162 percent in that period, health-care spending up 450 percent.

Kuttner notes that "the 19th century was the golden age of public planning for public spaces." But government was much smaller as a percentage of GDP in the 19th century.

Even since Kuttner's glory days of the 1950s, government spending has soared. Local governments have taken on every task from special education to grief counseling to public golf courses to city-planning seminars in the Caribbean; they have massively increased spending on various forms of welfare; and they have been forced to comply with reams of red tape and regulation that make every construction project far more expensive than it needs to be.

The 1986 story of Donald Trump and the skating rink is a classic example of the contrast between public and private construction projects. In 1980, New York closed the 30-year-old Wollman Memorial skating rink, saying it would take two years and $4.9 million to restore it. After wasting six years and $12.9 million, the city had to start over; it would need two more years and $3 million more. Enter Trump. After persuading then-Mayor Ed Koch to let him do it, Trump completed the job in three-and-a-half months and $750,000 under budget.

Why do market-provided services generally work better than taxpayer-funded services? Because incentives matter. Investors who put their own money into a project have a great deal to lose if they take six years to complete a four-month project. Employees of private companies are much more conscious than government employees that if they do a bad job they could be fired—or the entire company could fail. And as much regulation of business as there is, there is even more regulation of government projects. New York City has to adhere to New York State's Wicks law, which requires government agencies to hire separate contractors for construction, plumbing, electrical, and heating and ventilation work. It must use an elaborate bid process to find the lowest bidder—but it must also adhere to the federal Davis-Bacon Act, which requires that federally funded projects (which includes most local construction projects) pay union wages, and it must comply with various gender, race, small-business, and veterans' preferences.

Kuttner is pleased as punch that the small town of Brookline has "at last" built a retaining wall to prevent the local schoolyard from "turning into rivers of mud every spring." "How marvelous," he writes, "to see the public sector doing something so thoughtfully and well."

Talk about low expectations in our nation's schools. Private companies are building high-speed information networks, global satellite systems, Disney Worlds around the globe, and 1.6 million housing units every year. And the city of Brookline has done a marvelous job on a retaining wall, at last.

We've had another generation of private progress and public deterioration since the publication of *The Affluent Society*, and it sounds like even our most enthusiastic statists don't have very high hopes for government services any more. With good reason.

—David Boaz
Executive Vice President
Cato Institute

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000

150 Years and Still Dismal!

by David M. Levy

In December 1849 Thomas Carlyle published "Occasional Discourse on the Negro Question" in the London monthly *Fraser's Magazine.* In it he labeled the economics of his contemporaries "the dismal science." In the next issue of *Fraser's,* the greatest British economist of that era, John Stuart Mill, responded. That brief exchange—it counts less than 20 pages—is at the very heart of the nature and significance of classical British economics.

While everyone has heard that economics is the "dismal science," almost no one in economics these days seems to know what aroused Carlyle's ire. The failing is not Carlyle's; he is as clear as can be as to what exactly is the problem with economics. It stands opposed to racial slavery. In the passage I quote next—which contains the first use of "dismal science" in the language—the only fact that a modern reader lacks is that Exeter Hall was the heart of organized Evangelicalism, the moral center of the British antislave movement:

> Truly, my philanthropic friends, Exeter Hall Philanthropy is wonderful; and the Social Science—not a "gay science," but a rueful [one]—which finds the secret of this universe in "supply-and-demand," and reduces the duty of human governors to that of letting men alone, is also wonderful. Not a "gay science," I should say, like some we have heard of; no, a dreary, desolate, and indeed quite abject and distressing one; what we might call, by way of eminence, the *dismal science.* These two, Exeter Hall Philanthropy and the Dismal Science, led by any sacred cause of Black Emancipation, or the like, to fall in love and make a wedding of it,—will give birth to progenies and prodigies; dark extensive moon-calves, unnameable abortions, wide-coiled monstrosities, such as the world has not seen hitherto!*

Much of the rest is unprintable in this respectable periodical; it reads like the vile racist screed it is. Nonetheless, if one can bear the racial pornography, Carlyle makes a point of vital importance: the economics of his contemporaries in its idealization of market relationships among equals stands in opposition to his dream of slavery's hierarchical obedience.

Too often soft-pedaled by those who admire his attack on economics, Carlyle was the premier theorist of the idealized slave society. In opposition to the economists' supply-and-demand model of human society, he put forward the doctrine of obedience to one's betters. While he had been making such

David Levy is a professor of economics at George Mason University.

*[Thomas Carlyle], "Occasional Discourse on the Negro Question," *Fraser's Magazine for Town and Country,* December 1849, pp. 672–73.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

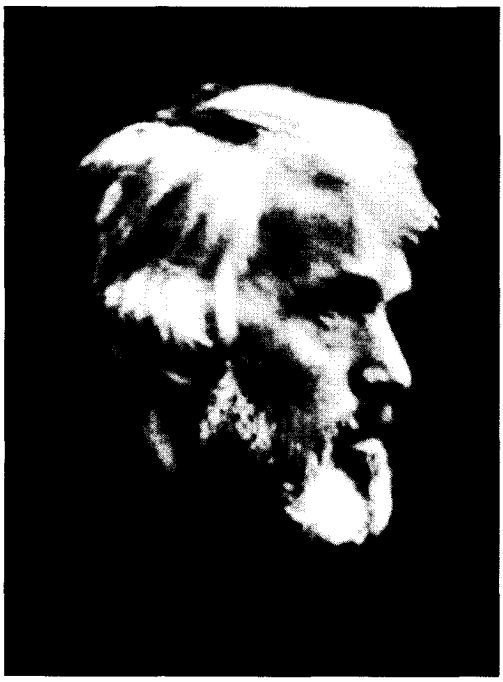


PHOTO BY JULIA MARGARET CAMERON, COURTESY MINNEAPOLIS INSTITUTE OF ARTS

Thomas Carlyle

arguments through the 1840s, it wasn't until the "Negro Question" that he realized that all white people are "better" than all black people. This certainly made the idealized slavery more attractive for white Britons than one in which they might be on the cutting end of the "beneficent whip"—a phrase in "Negro Question" that Mill singled out for particular attention.

Carlyle idealized slavery in the same way economists idealized markets. To match the economists' claim of mutual gain from exchange, Carlyle put forward the doctrine of the joys of service to one's betters. And according to the way things were supposed to work, the common religion would give the details of the hierarchy. (This is why Carlyle and his admirers often had "problems" with Jews; in particular, why we find the Anglo-German writer H. S. Chamberlain cited in *Mein Kampf* for his rants on the subject.)

Then and now, justification of slavery by any name assumes the benevolence of masters. It is with respect to the claim that slavery is a more benevolent institution than markets that I propose we read the sexual references in the "dismal science" passage quoted above. One of the most effective pieces of economic analysis of the time was Harriet Martineau's demarcation of the hidden economics of interracial sexuality in the American south. This demonstration, when retold in fictional form in *Uncle Tom's Cabin,* devastated the pretensions to slavery owners' benevolence.

The lack of public prostitution in southern cities—a fact that had been pointed to as evidence of the moralizing effect of slavery in the debates of the time—was explained by Martineau's extension of classical population theory. Why would a man rent a woman by the hour when he could buy her and keep the children for resale? Colored children, after all, followed the status of their mother. Slave concubinage replaced public prostitution. After Martineau, everyone knew how to see this. And by seeing this, one knew all there was to know about the benevolence of those with absolute power over the lives and persons of their subjects.

Interpreting the Facts

When we view the past through the lazy status quo of the present, we are liable to take as conservative those forces that helped effect this status quo regardless of the direction in which the world was moved. Economists who helped end racial slavery are in modern accounts judged *reactionaries* by modern readers who find it impossible to imagine that anyone of intelligence and integrity would defend racial slavery. With this failure of imagination comes the inescapable conclusion that the only possible direction from which classical economics can be attacked by someone serious is from the pro-socialist direction.

Of course this failure of imagination is aided and abetted by strategic silence. If a student knows the Carlyle-Mill debate, it is impossible to think of the classical economists as taking the reactionary side in the Victorian debate over social organization. The alternative to markets was not socialism. There were socialist experiments, but there were no socialist economies. The alternative to market organization was slavery. Teachers

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

have to work rather hard to hide this fact. For instance, when students in classes in British literature encounter Charles Dickens's 1854 *Hard Times,* with its savage attack on markets and market economics, teachers wishing to present Dickens as "progressive" have to be careful. When they explain why it is "inscribed to Thomas Carlyle," it is probably helpful to their cause if they not mention that in 1853 Carlyle republished an expanded version of his part of the exchange with Mill under the title *Occasional Discourse on the Nigger Question.* What would modern students think if they knew that the attack on market transactions came from those who idealized slavery for black people?

The Carlyle-Mill debate was a theoretical debate. Ideas do have consequences. The issues stopped being purely theoretical in what historians call the "Governor Eyre controversy" of mid-1860s Britain. What ought we to do about those responsible for an administrative massacre of nonwhite Jamaicans? On the side demanding colorblind justice we find the old coalition Carlyle opposed, antislave Evangelicals and economists now joined by Charles Darwin and T. H. Huxley. In opposition we find all the major antimarket voices in Victorian literature—Dickens, John Ruskin, Charles Kingsley, and Alfred Tennyson—joining Carlyle in making the case that it could not be murder to kill Jamaicans of color because one could only murder people.

The defeat of the Evangelical-economic coalition was complete. Eyre walked; Mill lost his seat in Parliament; the century of administrative massacre began. And the episode is never mentioned when in English classes the stories of the progressive literary figures and the heartless economists are retold.

One of these days students will learn how to read the silence between the lines. □

THE FREEMAN
Ideas On Liberty

1999 Bound Volume

The 12 issues from January through December 1999 have been gathered into a single volume—sturdily sewn with navy blue cloth cover and gold foil stamping—768 pages, fully indexed for handy reference to the latest literature of freedom. More than 100 feature articles on topics such as antitrust, education, environment, government regulation and control, health care, individual rights, labor, money, private property, and international trade. Columns by Walter E. Williams, Mark Skousen, Larry Reed, Dwight Lee, Doug Bandow, Charles Baird, Russell Roberts, Sheldon Richman, and Thomas Szasz. Reviews of more than five dozen books—and all of Don Boudreaux's messages.

$24.95 each

Save! Special introductory price: $19.95, through April 30, 2000

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000

The Irresistible Force of Market Competition

by Israel M. Kirzner

The systematic character of the market process derives, in the Austrian view, from the interplay of the actions of entrepreneurial human beings. Entrepreneurs act imaginatively and creatively, seeking to identify and to grasp market profit opportunities (generated by earlier entrepreneurial limitations of vision). As a result of the interplay of such entrepreneurial acts of vision, product prices and quantities of product offered for sale tend to be nudged systematically in the direction of the market-clearing price/quantity configuration.

In the present article we draw attention to the essentially *competitive* character of this entrepreneurial process and draw out some critical implications for any assessment of governmental antitrust policies. We must begin by pointing out certain crucial ambiguities that have long plagued economists' use of the adjective "competitive." The problem was identified over half a century ago by F. A. Hayek; despite the valiant efforts of Hayek and others, the problem continues to confuse both economists and the public.

The Meaning of Competition

For the mainstream of economic theory the notion of competition has come to be associated with the *absence of market power* (to effect change in price or product quality). A competitive market is one in which no firm possesses market power. There is a certain reasonableness to this use of the term. Competition is seen as the antithesis of monopoly. Monopoly is identified with possession of the power to name one's price without having to worry whether this will encourage one's potential customers to seek more favorable terms elsewhere.

Competition is therefore reasonably understood to mean the situation in markets where such monopoly power is absent. "Perfect" competition therefore came to mean the situation in markets where each and every participant lacks *any* power whatever directly to influence product price or product quality. The conditions needed to define such a perfect situation are, as we would expect, completely unrealistic, including (as we saw in the first in this series of articles) universal perfect information concerning all current market events and potential events. But this is not necessarily a damning weakness; the notion of the state of perfect competition is, after all, seen in mainstream economics not as a description of reality, but as a model able to serve (a) as a theoretical framework helpful for understanding real-world markets, and (b) as a yardstick of perfection against which to assess the seriousness with which real-world situations (of less-than-"perfect" competition) fall short, in terms of the resulting pattern of resource allocation, as compared

Israel Kirzner is a professor of economics at New York University and author of The Meaning of Market Process. *This is the third in a series of articles laying out some foundational elements of modern Austrian economics.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

with the perfectly competitive efficiency ideal. It is this model of perfect competition which is, in mainstream economics, seen as the heart of the law of supply and demand, and which has, in the history of modern antitrust policy, driven governmental efforts to "maintain competition"—that is, to secure a structure of industry reasonably close to the perfectly competitive ideal.

For Austrians, however, the term competition has a *completely different meaning,* both for understanding how markets work and for formulating public policy in regard to the structure of industry. Austrians find the mainstream meaning of "competition" not only unhelpful, but in fact grossly misleading in terms of economic understanding. For Austrians it is clear that to seek to emulate an "ideal" state in which no single entrepreneur can have impact on market price or output quality is in effect to seek to paralyze the competitive market process.

Following a long tradition in economics going back at least to Adam Smith, Austrians define a competitive market not as a situation where no participant or potential participant has the power to make any difference, but as a *market where no potential participant faces nonmarket obstacles to entry.* (The adjective "nonmarket" refers, primarily, to government obstacles to entry; it is used to differentiate such obstacles from, for example, high production costs that might discourage entry. These latter do not constitute noncompetitive elements in a market; to be able to enter means to be able to enter a market if one judges such entry to be economically promising—it does not mean to be able to enter without having to bear the relevant costs of production.) That is, a situation is competitive if no incumbent participant possesses privileges that protect him against the possible entry of new competitors.

The achievements that free markets are able to attain depend, in the Austrian view, *on freedom of entry, that is, on the absence of privilege.* It is because the law of supply and demand (as understood by Austrians) depends crucially on freedom of entry that this meaning of the term "competition" is so important. As we shall see, it is because of this importance that so much twentieth-century antitrust policy can be seen as positively harmful, as seriously obstructing the competitive-entrepreneurial market process.

Semantics and Substance

Certainly the dispute concerning the meaning of "competition" is a semantic one. But, together with, and underlying, the semantic squabble (which, admittedly, should not overly concern us as economists; after all, new terms can be coined that are not subject to misunderstanding), there is a profound substantive disagreement concerning the way in which markets work. The mainstream notion of competition sees it as a *state of affairs*: the notion of competition has nothing to do with the *process* through which the market achieves its results. For Austrians, on the other hand, it is the market process that is important. And that market process cannot be imagined at all without *necessarily* departing from that state of complete powerlessness which mainstream economics sees as perfectly competitive. For Austrians the adjective "competitive" captures the essential feature of the market *process*.

In other words, entrepreneurial actions that are, in the Austrian sense of the term,* seen as essentially and emphatically *competitive*, as critical steps in the market process, are, in the mainstream view, seen as *anti*competitive, as monopolistic, as aberrations to be eliminated for the sake of the efficient-market ideal. As a result of this confusion of thought in twentieth-century economics, governments ostensibly intent on maintaining the competitiveness of markets have been seen as having the obligation to outlaw and zealously stamp out the very actions through which ordinary competitive strategies are effected. A brief glance at typical tools in the antitrust kit can help illustrate this Austrian critique.

Some Tools of Antitrust

Obstructing mergers. Antitrust policy has traditionally frowned upon (and often prohib-

*This is also the sense universally adopted by business people, and the sense once universally followed by economists as well.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ited) mergers between hitherto competing firms. The rationale is, given the mainstream perspective, obvious and plausible. Replacing two competing firms by one larger firm cannot but constitute a reduction in the degree of market competition (in the mainstream definition of the term). Two less powerful firms have been replaced by one more powerful firm.

But the Austrian view must be that such a merger, provided the potential entry of others has not been and is not being artificially blocked, is itself an entrepreneurial act, a *competitive* act; *the blockage obstructs the way in which market competition is able to discover the best size of firms and thus the lowest cost at which production can be maintained.* (Even if a single firm supplies an entire industry, the industry is still competitive, in Austrian terminology, so long as the firm is kept on its toes by the potential threat of new entrants into *this* industry, as well as by the threat and/or reality of competition from industries producing substitute commodities.)

Outlawing price collusion. A group of powerful firms may collude to keep prices high; their motives may be to cartelize the industry, to eliminate interfirm competition and thus to force the consumer to pay more. For this reason antitrust policy has of course been directed toward preventing such price collusion. But the Austrian perspective sees matters quite differently. Even where the *motive* is indeed to paralyze interfirm competition, such collusion is itself a competitive step—since, *in the absence of artificial blockage against entry*, such collusion can be taken only in the face of the threat of competition from new entrants (who may in fact be able to profit by offering to sell at lower prices). No one knows when a price is "too high"; only the competitive process of entry (or of the threat of potential entry) can reveal the lowest level of price that can be sustained. So long as entry is open, the colluding firms may, in seeking to maintain their higher prices, be unwittingly attracting new entrants to reveal the truth that lower prices are sustainable. Or they may, if no such new entry occurs, be demonstrating that the cost structure indeed dictates these higher prices, as being the lowest ones sustainable in a competitive world.

Preventing predatory price-cutting. What seems, from the mainstream perspective, a clear strategy of eliminating competition occurs where a large firm temporarily keeps prices very low, thus forcing smaller competing firms out of the industry, and is then able to raise prices drastically with impunity. Careful theoretical and historical analysis has cast serious doubt on even the possibility that such a strategy could be successful and on the validity of the classic claims that such strategies were indeed employed around the turn of the century in U.S. industry. But the Austrian objection to government attempts to limit so-called predatory price cuts does not rest on this analysis. Rather the Austrian objection is that, *so long as entry is not artificially blocked*, even where "monopoly" positions have indeed been acquired through "predatory" price-cutting, these positions have been acquired as part of the competitive process, and can only be maintained in the teeth of new potential competition.

No one can know when a price cut that eliminates a competitor is intended to establish a "monopoly"; more to the point, even an attempt to establish a "monopoly," *taken in the face of freedom of entry*, is itself a competitive step. No one denies that economic muscle may be used to confront consumers with higher prices. But if competition can indeed conceivably serve the consumers better, then these higher prices are themselves the way—the *competitive* way—through which it becomes profitable for new entrants to discover how better to serve consumers.

Inexorable Market Competition

Our desperately brief glance at antitrust attitudes should perhaps suffice to confirm our central Austrian thesis: What is needed to stimulate that all-powerful entrepreneurial-competitive process upon which the free market depends is nothing more than freedom of entry to anyone with an idea of how to profit by serving consumers more faithfully than

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

they are being currently served. It is important to remember that no claim is made that freedom of entry entails that competitors refrain from attempts to monopolize markets. They *may* attempt to do so; and certainly their efforts may possibly place the consumer in a worse position (than he might be under a system reflecting perfect knowledge). The Austrian claim is that since no such perfect knowledge can exist, we must rely on the competitive-entrepreneurial process to reveal how the consumer may be better served. To *obstruct* this process in the name of competition (!) is to undermine the only way through which the tendency toward social efficiency is possible. By obstructing or preventing entrepreneurial steps taken that do not fit the "perfectly competitive" model of universal utter powerlessness—even if such obstruction or prevention stems from the best of intentions on behalf of consumers—government is necessarily tending, to a greater or lesser extent, to paralyze what is truly the competitive process. □

THE CLASSIC BLUEPRINT FOR A JUST SOCIETY

THE LAW

BY FREDERIC BASTIAT

New Introduction by
WALTER E. WILLIAMS
Foreword by
SHELDON RICHMAN

"Phenomenal! An amazing and timeless treatment of the cost of using government to solve problems."
— Russell Roberts, author of *The Choice*

3 copies for $10.00 postpaid
96 pages with index, paperback (quantity discounts available)

Please send check or money order to:
FEE, 30 South Broadway, Irvington-on-Hudson, NY 10533
Credit card orders: 1-800-452-3518

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000

Hospital Food and Socialized Medicine

Hospital food is rarely mistaken for gourmet cuisine anywhere, but at least it's not an issue over which major political campaigns are waged. Except in Canada, that is.

Last September, a colleague of mine visited Manitoba, a province in central Canada. Electioneering was at a fever pitch, with just a few days left before voting for a variety of public offices. My friend was astonished to observe that the dominant issue was indeed hospital food. It had become a political hot potato, the candidates outdoing one another to express concern and promise action.

The unhappy patients of Manitoba's hospitals and personal-care homes have complained for months about the introduction of "rethermalized food"—cut-rate meals prepared 1,300 miles away in Toronto, then frozen and shipped to Manitoba, where they are nuked in microwave ovens and served. Peter Holle, president of the Frontier Centre for Public Policy in Winnipeg, explained to me that the rethermalized meals idea was a cost-saving "innovation" of government bureaucrats employed by regional health authorities.

"Never mind that they taste like cardboard," says Holle. "Never mind that individual tastes and circumstances might dictate decentralized food services. Reheated meals became a symbol of efficiency for the supposedly compassionate do-gooders in government. Why pay hundreds of workers in dozens of Manitoba kitchens when we can just zap up frozen dinners from Toronto? Somebody suggested that the province could save more money by serving these meals in the legislature's dining room too, but that was one idea that the politicians dismissed as truly half-baked."

As it turned out, unease with the government's handling of health care, including vile victuals, was one reason the incumbent government in Manitoba went down to defeat.

How to Politicize an Issue

How does hospital food become a political issue? The same way anything—from the important to the utterly inconsequential—becomes a political issue: *socialize it.* Take any matter that people normally resolve quickly, peacefully, and privately by their own choices and initiative, turn it over to government, and watch what happens. Factions arise. Conflict ensues. Problems appear.

Indeed, by turning such matters over to government, you can actually ensure that minor problems become big and intractable. Government makes decisions that it finances by taxes and imposes with its police power. That employment of force guarantees that somebody, if not everybody, will be unhappy. If they can't escape the system because they're forced into it, then they'll bicker and fight endless and often silly battles.

Lawrence Reed is president of the Mackinac Center for Public Policy (www.mackinac.org), a free-market research and educational organization in Midland, Michigan, and chairman of FEE's Board of Trustees.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

This is yet another argument for keeping government confined to a few basic functions like defending life, liberty, and property. Life is too short to waste precious time politicking about hospital food. Can you imagine having to put the affairs of your own home kitchen up for a public vote?

If Washington nationalized the auto industry, we'd get the cars that bureaucrats wanted us to have. If you didn't like the quality or the color choice or the price, you could hope somebody runs for office and changes things from the inside. In a free market, if you don't like Ford, there's no need to go to the polls or bribe your congressman; you just buy something else. Politics is simply no way to run a kitchen or a car factory or a whole lot of other things.

The health-care system Canadians endure suffers from socialization, which explains why hospital food is probably among the least of their concerns. According to a national poll, four out of five Canadians are unhappy with the health-care system and believe it has worsened noticeably in just the past five years. Doctors in Manitoba apparently agree with the majority of Canadians. Almost half of them—an astonishing 1,800—have left the province in this decade alone.

David Gratzer, a prominent Canadian health-policy commentator, published a blockbuster book last year entitled *Code Blue*, in which he skewers the country's socialized system. Gratzer reveals in painful detail that the quality of care that Canada's system provides to ordinary citizens matters less to its apologists than the quality of care it denies to the so-called rich. The egalitarian impulse that drives Canada's "universal" health-care system calls for treating everybody the same; all patients get "free" care in the public system and are generally denied the option of getting faster or better care for a fee in the private sector.

Gratzer makes a telling point with a rhetorical question: "With health care, is our true goal that Mr. Smith, who owns three cars, not be allowed to get a quick (private) cataract surgery? Or is it that Mr. Jones, who just makes rent every month, gets (publicly funded) heart surgery when he needs it? The way [the system's] advocates carry on, you'd think that it was fine that Mr. Jones suffered crushing chest pain after walking three steps just as long as Mr. Smith had to stumble around blindly for six months."

Thanks to this egalitarian idiocy, an estimated 212,990 Canadians were on hospital waiting lists for surgical procedures in 1998, a 13 percent increase over 1997. According to the Fraser Institute of Vancouver, British Columbia, patients waited a median of 6 weeks after referral by a general practitioner for a consultation with a specialist and another 7.3 weeks after the consultation to receive treatment. The median total waiting time of 13.3 weeks was up from 11.9 weeks in 1997 and up a shocking 43 percent since 1993.

The gap between the amount of time specialists considered clinically reasonable and the actual waiting time after consultation was greatest for elective cardiovascular surgery, for which the actual waiting time was 8.1 weeks longer.

The Fraser Institute points out that while Canada's spending on health care as a percentage of gross domestic product is the fifth highest among nations of the Organization for Economic Cooperation and Development (OECD), the country ranks in the bottom third in availability of most medical technology. For example, for every million people, Canada has 1.7 magnetic resonance imagers (MRIs), a cutting-edge diagnostic tool, compared to the OECD average of 4.2 and the U.S. figure of 16. No wonder that when former Quebec Premier Robert Bourassa was diagnosed with cancer, he didn't stick around to get free care in his home country; he high-tailed it to Cleveland.

The lesson from Canada? Politicians shouldn't be trusted with the health care hospitals provide any more than they should be trusted with the food that hospitals serve. □

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000

The Myth of the Social Security "Trust Fund"

by John Attarian

In my mail the other day, I received a hint of why Social Security reform isn't happening.

It was an unsolicited letter from a lobby for the elderly called The Seniors Coalition, warning that "something terrible is happening in Washington. . . . Something sinister and dangerous is happening as you read this note." The Coalition had "exposed the truth about the looting of the Social Security Trust Fund." But when the Coalition's founder died, "our enemies saw an opportunity. . . . [T]he Washington Insiders stole another $1.2 billion from the Social Security Trust Fund." After railing for four pages about these nefarious "insiders," the author exhorted me to send money and to sign and return the enclosed petition demanding that Congress "Stop the raid on the Social Security Trust Funds. Immediately repay all monies that were illegally diverted from these Trust Funds."[1]

The Seniors Coalition claims to represent three million elderly people.[2] Imagine their constituents who read this scare mailing about how "they" are looting Social Security's "Trust Fund." Imagine three million signed petitions reaching Congress. Multiply that a few times to cover other elderly lobbies' efforts—and you start to see why changing Social Security is so hard.

John Attarian is a freelance writer in Ann Arbor, Michigan, with a Ph.D. in economics. Under a grant from the Earhart Foundation, he has completed a book on Social Security, from which parts of this article are adapted.

Much of the public is convinced that a perfidious Congress is rifling a "trust fund" where our Social Security taxes are "held in trust" to pay future benefits, that this is why Social Security is headed for trouble, and that all Congress has to do to fix Social Security is put this stolen money back. These beliefs crop up perennially in letters to editors.

In July 1998, Carolyn Lukensmeyer, director of the Americans Discuss Social Security project, told the Senate Special Committee on Aging that this alleged raiding of the trust fund to finance other spending is "the real focus of the public's concern." Her poll found that 79 percent of respondents believe that this is one reason why Social Security might experience financial crisis, and 45 percent believe it is the *main* reason. (Just 26 percent answered, correctly, that the main reason is that the elderly population is growing faster than the number of workers financing the program.)[3]

Obstacle to Reform

This mentality is a serious obstacle to Social Security reform. If a looted trust fund is the problem, why bother overhauling Social Security? Just make Congress return the money.

Yet this popular belief is utterly mistaken. There is no trust fund, and Congress is doing nothing wrong. What's more, the source of this misunderstanding is the government's own public-relations efforts to create support for Social Security.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

The Social Security Act of 1935 created an "Old-Aged Reserve Account" in the Treasury and required that every year an amount determined sufficient to pay that year's benefits was to be appropriated to it. Any of this money not needed for benefits was to be invested in federal debt (including unmarketable debt issued for this purpose) earning 3 percent interest, or other government-guaranteed debt.[4]

Presently, criticism arose. Winthrop Aldrich of Chase National Bank argued that the reserve would be fictitious; the government would just be issuing promissory notes to itself. As for interest on the bonds, which would supposedly help pay future benefits, the government would get the interest money from "the only source it could obtain it—the general taxpayer. The whole elaborate reserve set-up would not relieve him of any burden whatever." Finally, the tax revenue the Treasury got in exchange for the bonds would be a standing temptation to extravagant spending.[5] In his Milwaukee speech on Social Security during the 1936 presidential campaign, Republican candidate Alfred "Alf" Landon said much the same thing. It was as if, he charged, a father took deductions from his children's wages to invest for their old age, "invested" them in "his own IOU," and spent the money, leaving his kids nothing but those IOUs. Hence Social Security's forced savings were "a cruel hoax."[6] President Franklin Roosevelt retorted that Social Security tax dollars "are held in a Government trust fund solely for the social security of the workers."[7]

Yet attacks kept coming. Critics such as General Hugh S. Johnson, former head of the National Recovery Administration, and journalist John T. Flynn pointed out that unlike insurance companies, which invest their premiums to build a reserve to pay on their policies, the government was only issuing claims on itself. Hence the Social Security reserve was merely worthless IOUs. To pay future benefits, Americans would have to be taxed all over again.[8]

Defenders responded that the IOU talk was misleading; aren't all private investment instruments, such as stocks, notes, and bonds, really IOUs, their value dependent on the resources and ethics of the firms issuing them? In investing in government bonds, the Treasury was behaving just like a bank, which invests its depositors' money rather than hoard it as cash.[9]

The critics were right. Of course the Treasury spent the money obtained in exchange for the bonds in the reserve; what else could it do? Of course, the bonds were IOUs; all debt instruments are. Of course, the interest would come from the taxpayers; where else could it come from?

Embezzled Funds?

When in 1939 the Roosevelt administration proposed various amendments to Social Security, congressional hearings and debate on the proposals saw extensive airing of the reserve fund controversy. Critics accused the administration of "embezzlement" and repeated the charges that the reserve was merely IOUs, and that Americans would be taxed twice. No embezzlement was occurring, defenders retorted; there wouldn't be any double taxation, and the much-maligned IOUs were the safest investment around—U.S. government bonds. They raised a valid point: holding the surplus as cash was silly, and buying private securities was not allowed. So where else could the Reserve Fund money go but into Treasuries?[10] By now three years old, the reserve-fund controversy had become a serious blow to Social Security's prestige.

On the recommendation of Treasury Secretary Henry Morgenthau, the Social Security Amendments of 1939 created an Old Age and Survivors' Insurance Trust Fund at the Treasury. This was done for the express purpose of ending the controversy. Testifying before the Senate Finance Committee during the hearings on the amendments, Social Security Board Chairman Arthur Altmeyer stated that the purpose of the trust fund was "to allay the unwarranted fears of some people who thought Uncle Sam was embezzling the money."[11]

Creation of Social Security's trust fund, then, was a public-relations ploy.

What happened exactly? Section 201 of the Social Security Act, "Old-Age Reserve

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Account," was replaced by a new Section 201, "Federal Old-Age and Survivors Insurance Trust Fund." The only substantial change was elimination of the transfer of revenues from the Treasury's general fund via *specific* annual appropriation to the Reserve Account. Instead, a sum equivalent to the Social Security taxes received and put into the Treasury "is hereby appropriated" to the Trust Fund for the fiscal year ending June 30, 1941, "and for each fiscal year thereafter"—that is, *automatically*. The only other new features were a Board of Trustees (the secretaries of the treasury and labor and the chairman of the Social Security Board) to manage the fund, replacement of the 3 percent interest rate with the average rate on interest-bearing federal debt, and a provision for paying money from the fund into the Treasury to defray Social Security's administrative expenses.

Otherwise, the Trust Fund operated just like the old Reserve Account. Indeed, it *was* the Reserve Account; its assets as of January 1, 1940, were transferred to the Trust Fund. Since the Reserve Account was, according to the Act, "an account in the Treasury" and the Trust Fund was "on the books of the Treasury," the transfer was a formality. It was as if a shoebox full of bonds labeled "Reserve Account" was relabeled "Trust Fund." Moreover, the key paragraphs of the new Section 201, for example, regarding the duties of the Trust Fund's "Managing Trustee" (the treasury secretary) to invest the fund's surplus in only certain types of U.S. government debt, correspond almost verbatim to paragraphs in the old one.

Social Security's Trust Fund, then, is really a Treasury account, nothing more.

What's a Trust Fund?

Is it a real trust fund? A trust fund is money, investments, or other property held in a trust, a trust being "A fiduciary relationship with respect to property, subjecting the person by whom the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it." All trusts must have a "settlor," who sets up the trust and puts property into it; a "trustee," who manages the trust and has legal title to the property in it; a "beneficiary," who holds equitable title to the property and for whom it is managed; property; and terms of trust stating its purpose and duties, the powers of the trustee(s), and the beneficiary's rights.[12]

Does Social Security's Trust Fund meet these criteria? You judge.

Though Congress legislated the Trust Fund, it is not the settlor, because a settlor puts *his own* property into a trust, which Congress did not do.[13] As for the Board of Trustees, who in a true trust would hold the legal title to its property, Section 201 of the 1939 Amendments did not even mention its having title to anything.

Nor do the purported trust "beneficiaries" have property in the fund to which they have an enforceable property right, as beneficiaries of a true trust do. Under questioning by Representative John McCormack of Massachusetts during the 1939 hearings, Board Chairman Altmeyer revealed that Social Security maintains no accounts containing funds earmarked for individuals, and never had.[14] Its accounts, then, are just record-keeping entities: file folders, not piggy banks. No individual funds necessarily means no individual property in the Trust Fund.

Section 201 said nothing about property rights—for good reason. In arguing *Helvering v. Davis* (1937), the Supreme Court decision that upheld Social Security's constitutionality, Assistant Attorney General Robert Jackson stated that under Social Security, "There is no contract created by which any person becomes entitled as a matter of right to sue the United States or to maintain a claim for any particular sum of money. Not only is there no contract implied but it is expressly negatived, because it is provided in the act, section 1104, that it may be repealed, altered, or amended in any of its provisions at any time."[15]

And the government's brief for the Supreme Court case *Flemming v. Nestor* (1960) argued that a current or prospective Social Security beneficiary does not acquire an interest in the Trust Fund—that is, a property right to its assets—and that the belief that Social Securi-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ty benefits are "fully accrued property rights" is "wholly erroneous."[16] The Court concurred.[17]

All this confirms the observations by Suffolk University Law School Professor Charles Rounds, a fellow of the American College of Trust and Estate Counsel:

> Despite the term "trust," the Social Security system contains nothing that remotely resembles the common law trust. There is no segregation of assets, no equitable property rights, no private right of enforcement (all characteristics of the common law trust). It is merely a system of taxation and appropriation sprinkled with trust terms to hide its true nature.[18]

Moreover, Social Security's Trust Fund does not operate as a trust fund does. Social Security revenues go into the Treasury's general fund and are automatically credited to the Trust Fund in the form of Treasury bonds. The Treasury pays Social Security benefits and administrative outlays out of general revenue and debits the Trust Fund an equivalent value of bonds. Any leftover Social Security revenue finances general government operations, with an equivalent value of bonds remaining in the Trust Fund as Social Security's "surplus," to cover any revenue shortfalls.[19] This is how a Treasury account, not a trust fund, works. And calling a Treasury account a "trust fund" to influence public opinion does not make it one.

In all respects, then, Social Security's Trust Fund is bogus.

The adoption of the label "trust fund" for what was in fact a Treasury account was intended to cash in on the public's understanding of this term—that assets are absolutely safe, invested on one's behalf, and held for one's future use—and to reassure the public that Social Security was sound and trustworthy. It worked. The reserve controversy disappeared. Over the following decades, Social Security continued to make public-relations capital out of the term by repeatedly telling the public that benefits are paid out of a trust fund built up from their tax payments.[20]

But after the 1983 Social Security rescue, when Social Security revenues began exceeding outlays and sizable Trust Fund surpluses began accumulating, the charge of Congress's stealing Social Security's reserve money reappeared.[21] Talk of Congress's "raiding" or "dipping into" the Trust Fund to cover federal budget deficits continues to this day.[22] Spending the Social Security surplus, no real reserve, nothing but worthless IOUs—the old reserve-fund controversy all over again. With one decisive difference: the emotional evocations of the phrase "trust fund."

The New Dealers did not foresee that this phrase might some day work to weaken rather than strengthen faith in the government and in Social Security. Lifting assets from a trust fund is a serious crime and a breach of faith and trust. The more firmly people believe that the Social Security Trust Fund really is a trust fund, the angrier they will be at stories of Congress's looting it, and the more they will be inclined to believe that this is the reason that Social Security's financial prospects look shaky.

But as we have seen, there *is no trust fund to be looted*, only a Treasury account. And Congress is only doing what the Social Security law *requires*.

In adopting trust language to cure a Social Security public-relations problem 60 years ago, the federal government sowed the seeds of today's grave misunderstanding over the Trust Fund. This dishonest and misleading language should be abandoned immediately, the better to clear our minds of cant and false issues and enable us to see Social Security as it really is, grasp its real problems, and do what needs to be done. □

1. The Seniors Coalition, unsolicited mailing, received September 10, 1999.
2. Ibid.
3. U.S. Congress, Senate, *Living Longer, Retiring Earlier: Rethinking the Social Security Retirement Age: Hearing before the Senate Special Committee on Aging*, 105th Congress, 2nd session, 1998, pp. 84, 93, 121, 127.
4. Department of Health, Education and Welfare, Social Security Administration, *Social Security Act of 1935: Reports, Debates, Act, and Supreme Court Decisions* (Washington, D.C.: U.S. Government Printing Office, n.d.), 2 vols. Vol. 2 at VI, "Public—No 271—74th Congress," text of Social Security Act of 1935, pp. 3–4.
5. Winthrop W. Aldrich, "Social Security: An Appraisal of the Federal Act," *Vital Speeches of the Day*, August 1, 1936, p. 687.
6. Alfred M. Landon, "I Will Not Promise the Moon," *Vital Speeches of the Day*, October 15, 1936, pp. 26, 27, 28.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

7. Franklin D. Roosevelt, *The Public Papers and Addresses of Franklin D. Roosevelt*, vol. 5; *The People Approve 1936* (New York: Random House, 1938), p. 536.

8. General Hugh S. Johnson, "A Hokus-Pokus: The Social Security Tax," *Vital Speeches of the Day*, December 1, 1937, pp. 116–17; John T. Flynn, "The Social Security 'Reserve' Swindle," *Harper's*, February 1939, pp. 238–48.

9. See, for example, Beulah Amidon, "Old Age Reserve," *Survey Midmonthly*, September 1938, p. 284.

10. For discussions in Congress of "embezzlement" and IOUs, see, for example, U.S. Congress, House, 76th Congress, 1st session, February 27, 1939, *Congressional Record*, 84:1954–1961, and U.S. Congress, House, Social Security amendments debate, 76th Congress, 1st session, June 8 and 9, 1939, *Congressional Record*, 84:6854–6856, 6862, 6890–6893. For a defense of investing the reserve in Treasuries as the only feasible option, see, for example, U.S. Congress, House, Representative John William McCormack speaking on Social Security amendments, 76th Congress, 1st session, June 8, 1939, *Congressional Record*, 84:6855.

11. U.S. Senate, Committee on Finance, *Social Security Act Amendments: Hearings before the Senate Finance Committee on H.R. 6635*, 76th Congress, 1st session, 1939, p. 81.

12. Charles E. Rounds, Jr., and Eric Hayes, *Loring: A Trustee's Handbook*, 8th (centennial) ed. (New York: Aspen Publishers, Inc., 1998), pp. 1–2, 5, 79; Gilbert Thomas Stephenson, *Estates and Trusts*, 4th ed. (New York: Appleton-Century-Crofts, 1965), pp. 63–66.

13. Per author's telephone conversation with Professor Charles E. Rounds, Jr., of Suffolk University Law School.

14. U.S. Congress, House, Committee on Ways and Means, *Social Security: Hearings*, 76th Congress, 1st session, 1939, 3 vols., III: 2205–2206.

15. U.S. Congress, Senate, *Oral Arguments in Helvering et al. vs. Davis involving the Old Age Benefit Provisions of the Social Security Act before the Supreme Court of the United States, May 5, 1937*, S. Doc. 71, 75th Congress, 1st session, 1937, p. 16.

16. U.S. Supreme Court, *Records and Briefs*, October Term, 1959, No. 54, *Flemming v. Nestor*, Brief for the Appellant, pp. 10–11.

17. *Flemming v. Nestor*, 363 U.S. 603, at 608.

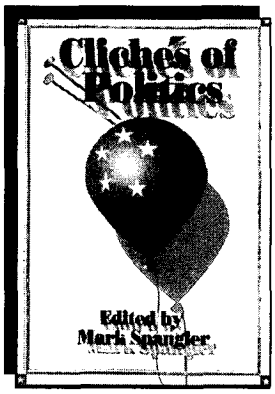
18. Professor Charles E. Rounds, Jr., "Will the Institution of the Trust Survive the Clinton Presidency?" *The Advocate*, Spring 1995, p. 31.

19. U.S. Congress, House, Committee on Ways and Means, *1998 Green Book: Background Material and Data on Programs Within the Jurisdiction of the Committee on Ways and Means*, pp. 73, 75.

20. See, for example, Social Security Board, *Changes in the Social Security Act: Old-Age Insurance*, I.S.C. no 35, temporary edition, September 1939, p. 3; Social Security Board, *2 Plans for Old-Age Security*, I.S.C. 42, n.d., p. 3; Social Security Board, *What Is Social Security? A Brief Explanation of the Social Security Act*, I.S.C. 1, July 1940, p. 10; Social Security Board, *Old-Age and Survivors Insurance for Workers and Their Families*, I.S.C. no 35, January 1943, p. 4; Social Security Administration, *A Brief Explanation of the Social Security Act*, 1947, p. 10; and Social Security Administration, *A Brief Explanation of Social Security*, I.S.C. no. 1, July 1957, p. 14.

21. See "The $12 Trillion Temptation," *Time*, July 4, 1988, p. 58; Paul Magnusson, "We Are Plundering the Social Security Till," *Business Week*, July 18, 1988, p. 92; and Alan S. Blinder, "Congress Should Keep Its Hands Off this Nest Egg," *Business Week*, July 4, 1988, p. 20.

22. "Social Security Crisis Is Bogus, Experts Say," *The Detroit News*, October 11, 1999, p. 3A.



Clichés of Politics

Mark Spangler, editor

Are you tired of hearing people tell you that "We need government to fix this"? If so, we've got just what you need: *Clichés of Politics*, now in its fifth printing. Edited by Mark Spangler, this book is a powerful antidote to statist claims that more government is better. *Clichés* is also a great resource for students addressing policy issues in research papers or in debate. Counter big-government bombast with *Clichés*!

324 pages, paperback ~~$9.95~~ **on sale for $6.95**

Please send check or money order to:
FEE, 30 South Broadway, Irvington-on-Hudson, NY 10533
Credit card orders: 1-800-452-3518

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000

In Defense of Grocery Coupons

by Bill Field

We've all had this aggravating experience: rushing through the grocery store to finish our shopping, hurriedly looking for the shortest line, congratulating ourselves as we get in a line with only one lady in front of us, and then wanting to scream when we see her pull a big batch of grocery coupons out of her handbag. Surely this is an egregious example of waste—of our time and of the store's and manufacturers' resources in handling all this paper. Surely government should come to the rescue and promote efficiency by simply outlawing grocery coupons. Wouldn't such an obviously beneficial action by government create wealth?

Such apparently appealing proposals are the reason why we need principles to guide our thinking. Without some general starting point for reasoning through specific issues, we can be easily taken in by the superficial allure of seemingly obvious solutions.

What is the best guide for economic issues? It is the following simple statement: the invisible hand works. Whenever someone proposes government action to solve a problem, the best immediate reaction is to ask why market forces can't provide a better solution. Given the overwhelming evidence of the vast superiority of the invisible hand versus the visible hand in dealing with economic problems, the burden of proof should be heavy on the advocate of government action.

Bill Field is a professor of economics at Nicholls State University in Thibodaux, Louisiana.

Let's apply our principle to the grocery coupon. A freely functioning invisible-hand process has yielded grocery coupons, and they are likely to continue for the indefinite future. Every entrepreneur, institution, and procedure in the market process is continually subject to the survivor principle: market success depends on producing value greater than the opportunity cost of resources used. In other words, those who survive and prosper necessarily make, on net, a positive contribution to economic wealth—the invisible hand works. Thus, grocery coupons are necessarily wealth-creating.

Clarifying the Obscure

For most economic activity, the validity of this argument is clear. No one doubts that the butcher, the baker, and the candlestick-maker create wealth. The same goes for people who produce cars, movies, and computers. On the other hand, the wealth created by coupons is obscure enough to escape most of us unless we think carefully about the subject.

How does issuing grocery coupons create wealth? Coupons allow sellers to engage in price discrimination—to sell the same product to different people at different prices. Consider a bottle of Heinz ketchup. The marginal cost of producing one additional bottle may be only 50 cents; but given the demand, the profit-maximizing price may be $1.50. At that price only people who prefer Heinz and who are not particularly price-sensitive will

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

buy Heinz. Others will buy the house brand for perhaps $1.00.

Heinz could sell much more ketchup if it lowered its price to $1.20. But it would lose more from lowering the price to those who would have bought at the higher price than it would gain from the additional customers attracted by the price reduction. Thus Heinz seems stuck serving only its dedicated customers, and those who are more price-sensitive seem stuck with the house brand.

Coupons resolve this dilemma. If Heinz issues a 30-cent-per-bottle coupon, price-sensitive individuals will be most likely to go to the trouble (bear the opportunity cost) of searching out the coupons. They will then be able to buy Heinz at a price of $1.20 while others are paying $1.50. Note that Heinz is better off (makes more profit), the price-sensitive customers are better off (they voluntarily searched out the coupons, revealing that they valued Heinz at $1.20 more than the sacrificed time and effort), and devoted Heinz customers are unaffected, buying ketchup at the same price as before. Thus grocery coupons are, on net, wealth-creating.

Checkout Delayed

But haven't we forgotten something here? What about the delays in the checkout lines? Aren't the delays an externality imposed on the rest of us? Of course the coupon users and the companies benefit. Otherwise coupons would have disappeared long ago. But isn't the cost imposed on everyone else ignored in the transaction, resulting in market failure?

The short answer is no. Obviously there is a delay cost imposed on patrons who use no coupons, but the storeowner has every incentive to consider that cost. After all, customers can go elsewhere. The storeowner may respond to this problem by opening additional lines. The appearance of delay may not reflect reality once the adjustment in the number of lines is taken into consideration. So there may actually be no costs imposed on those who don't use coupons.

But suppose no additional lines are opened or people at least think they're being delayed by coupon users. Anyone is free to open a store that refuses to accept coupons. Coupon-less customers could then rush to this store, and seemingly everyone would be happy. Unfortunately, it's not that simple. That stores generally accept coupons indicates that coupons are profitable. They enable stores to broaden their customer base while being compensated by the manufacturer for the handling expenses. A store that refuses coupons would have to charge higher prices to make up for the loss of manufacturers' payments or of coupon-sensitive customers. As usual, there's no such thing as a free lunch—if you want to save time by quicker checkout thanks to either more lines or nonacceptance of coupons, you will have to bear the associated cost. The scarcity of stores that refuse coupons reflects the general entrepreneurial judgment that most customers would not be willing to pay enough extra to make such stores profitable.

Thus grocery coupons increase the wealth of the companies that issue them, the consumers who use them, and the stores that handle them, while imposing no cost on nonusers that they could not avoid if they were willing to bear the associated burden. The invisible hand sometimes works in mysterious ways, but it does work. □

The apple icon identifies articles that are appropriate for teaching students several major subjects—including economics, history, government, philosophy, and current issues.

We also provide sample lesson plans for these articles on our Web site **www.fee.org** and in written form. Professors, teachers, and homeschooling parents need only to visit our Web site or request written lesson plans to take advantage of this unique service.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000

The Market for Space in the Market

by Gary M. Galles

Slotting fees—payments by producers for space on retailers' shelves—are under attack. According to Senator Christopher "Kit" Bond of Missouri, chairman of the Senate Committee on Small Business, which held hearings last fall, the practice "threatens competition, jobs and likely drives up the cost of putting food on the table for millions of American families" and is "fundamentally unfair and just plain wrong."

The core argument against slotting fees is that larger producers harm consumers by using their financial "deep pockets" to outbid smaller and newer competitors for prime shelf space, pushing them out or denying them entry into the market. This is alleged to restrict consumer choice and to give large firms the power to raise their prices in an anti-competitive manner.

Despite the surface plausibility of this argument, it fails to grasp the realities of grocery retailing. Rather than representing some anti-competitive restriction, shelf fees, which have been around for two decades, are an efficient response to the proliferation of food products and the resulting increasing scarcity of supermarket shelf space.

Decades ago, supermarkets were growing and had the space to carry most available items. Grocers needed to fill their shelves, so they charged no slotting fees. But that changed with the explosion in new products and variants of existing ones, particularly in the frozen-food, snack, and beverage sections. Now there are far more products (more than 100,000 grocery items) than space to carry them (a typical supermarket carries 30,000), and 15,000–20,000 more come out each year, making shelf space a scarce commodity. Slotting fees have arisen to allocate store space that is now far more valuable than before. Fees are the result of supply and demand, which is why more "productive" placements, which reflect more valuable locations, require larger fees; it's not an abuse of small producers and consumers.

Retail Risk

Because four out of five new products fail, new grocery items are inherently risky for retailers as well as producers. Shelf fees efficiently allocate such risks to producers. Since products that fail displace others that consumers would have valued more (retailers are just the agents of consumers), this is where that risk belongs. Why should retailers bear the cost (including the value of the lost traffic that other items would have generated) if a product flops with shoppers? Fees restrict large-scale introductions to items whose makers are willing to "bet" the value of the necessary shelf space on their success. Rather than reducing valuable consumer options (there are no fewer slots available as a result, and higher profits may lead stores to expand available shelf space), this system may more

Gary Galles is a professor of economics at Pepperdine University in Malibu, Calif.

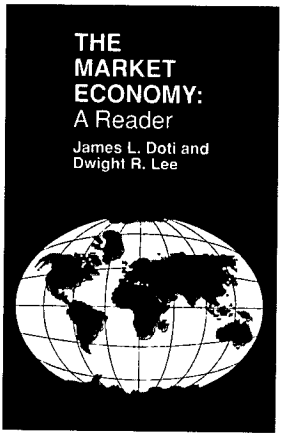
LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

quickly fill stores with the products consumers prefer by encouraging producers to do more and better market research before introducing products and by weeding out failures faster.

Senator Bond says his hearings "clearly indicate that competition is something less than free and open at the corner supermarket." However, all that the complaints against slotting fees really indicate is that some producers would prefer to use something valuable—supermarket shelf space—as if it were free. Being forced to pay for scarce shelf space is costly, but so is being forced to pay for workers, advertising, transportation, and anything else that is valuable. That some firms fail to receive scarce shelf space for free may frustrate them, but that does not reflect an anticompetitive abuse. And it's certainly not a reason for ham-handed government restrictions that would interfere with the efficient use of valuable resources and the more rapid discovery of those products consumers most desire. □

The Market Economy: A Reader

edited by James L. Doti & Dwight R. Lee



Looking for a great way to teach economics, or learn it yourself?

This outstanding anthology is an invaluable source book for students of free-market economics as well as for proponents of limited government.

Professors Doti and Lee have assembled a stellar list of authors—Adam Smith, Frederic Bastiat, David Ricardo (among the classical economists); Ronald Coase, Milton Friedman, James Buchanan, F.A. Hayek, Ludwig von Mises, and George Stigler (among the modern greats); in addition to Ayn Rand, Henry David Thoreau, Charles Murray, and others—to explain eight key issues: the invisible hand; markets and individual freedom; government regulation; the proper role of government; international trade; scarcity and social cooperation; income distribution; and imperfect markets.

What a joy to find—in a single book—Hayek's classic essay "The Use of Knowledge in Society"; Friedman and Stigler's wonderful work on rent control, "Roofs or Ceilings?"; Ayn Rand's essay on "The Nature of Government"; and Adam Smith's pivotal analysis of the division of labor.

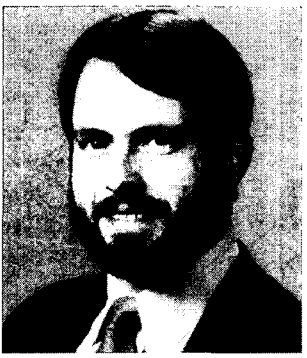
For anyone homeschooling children or anyone interested in deepening his or her knowledge of the relationship between economics and personal freedom, this book is not only essential, it's a real treasure.

362 pages, paperback

FEE special! $10.95
Plus $4.00 shipping and handling.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000



Stealing from ATM Machines

A few years ago, an ATM machine in Georgetown, an upscale neighborhood in Washington, D.C., malfunctioned. People lined up to clean out the $20 bills being handed out in place of $5 notes.

San Francisco voters essentially did the same thing last fall when they passed an initiative to ban ATM fees. Apparently the latest American entitlement is no-fee convenience cash. Banks should install ATMs, far and wide, but not charge noncustomers for using them.

The city council in Santa Monica, California, and the states of Connecticut and Iowa have enacted similar bans. Other cities are threatening to act. The Defense Department is considering imposing a prohibition for ATMs on military installations.

Naturally, the politicos argue that they are protecting the public interest. But—shock!—it turns out that banks are willing to fight back. In November, Bank of America and Wells Fargo announced that noncustomers would not be able to use the banks' ATM machines in Santa Monica. They said they would do the same in San Francisco if the California Bankers Association lawsuit against that city failed. Wailed one frustrated customer, "I use this [Bank of America] machine because it's convenient. My bank is a small bank and it doesn't have many ATMs."

Fair is fair, however. Why should banks pay to provide cash machines for people who have accounts at other institutions? Yet the believers in a free lunch were outraged.

USA Today editors called Bank of America and Wells Fargo "nasty" and "sour." The newspaper suggested that governments retaliate by withdrawing tax receipts from banks that impose a surcharge.

What better evidence is there of a government out of control? Most Americans would agree that the nation faces lots of serious cultural and social problems. ATM fees would not, however, seem to be particularly important. After all, no one has to use an ATM. Not that many years ago no one could, since they didn't exist.

But now there are more than 227,000 ATMs across America. The improved convenience for consumers is obvious. That benefit is now evident even overseas, where travelers can acquire foreign currency at a better exchange rate than from local merchants.

So banks and the other businesses that now routinely install ATMs are providing a service. People who use them believe the benefits of not driving across town to their bank are worth the cost. Why shouldn't ATM owners be compensated for their troubles?

The primary argument for not doing so is that Americans are morally entitled to free ATM service. Apparently we all have a right to life, liberty, the pursuit of happiness, and non-fee ATMs.

Whence that right stems is not clear. But it is a great principle. How about applying it

Doug Bandow, a nationally syndicated columnist, is a senior fellow at the Cato Institute and the author and editor of several books, including The Politics of Envy.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

elsewhere? The right to free cab rides and television repair? The right to free cable TV and telephone service? And so on.

Actually, ATM owners have a moral right to set their own fees. But, cry the *USA Today* editorial writers, "consumers need a break."

Everyone would like a break. By what standard are ATM fees too high?

The so-called U.S. Public Interest Research Group, a left-wing lobbying group, has led the charge, arguing that the fees, which now average $1.27 for large banks and $1.03 for small ones, are excessive.

Although everyone assumes that ATMs are cash cows, in fact they are not. Cash machines have not allowed banks to eliminate tellers. Explains analyst John Charles Bradbury, "Instead of substituting for and replacing tellers, ATMs have become a complementary service offered by banks."

A Federal Reserve study figured that banks lose an average of more than $10,400 a year per machine. As a result, the total industry loss exceeds $1 billion. A McKinsey & Co. study found that the machines have saved $200 million but cost $1.5 billion.

So why do banks offer ATMs? To attract customers. And why should banks, and especially nonfinancial institutions, add more ATMs? Until now, at least, they could collect fees.

As Bradbury has observed, "In the past, when there were no charges for ATM use, there were far fewer ATMs. A low-cost ATM needs at least 3,000 transactions a month to break even. With a fee, that number is cut to 500."

Indeed, prior to 1996 the major networks, such as Cirrus and Plus, banned fees. Later, they dropped the ban under pressure by member banks and, interestingly, the government. The Department of Justice considered filing suit against the prohibition as anticompetitive.

Governments may get away with banning ATM fees and not cause banks to yank out existing machines. But, as Bank of America and Wells Fargo proved, the banks can deny noncustomers access.

Moreover, banks—and nonfinancial companies that now provide half of new ATM machines—aren't likely to put them in new, and increasingly remote, locations. In fact, in recent years the greatest expansion has occurred in places such as convenience stores, grocery stores, shopping malls, and airports. The opportunity to get cash in such locations is worth far more than even the highest fee.

Once consumers find diminishing access, they will probably start clamoring for a subsidy. And the politicians, urged on by ATM-makers, will be only too happy to oblige.

The only conceivable role for government is to ensure that ATM machines list the fees charged. Indeed, last year's banking reform mandates disclosure and giving consumers the opportunity to cancel the transaction before any fee is charged.

Not even this step is necessary, however. Consumers can simply avoid any machine on which fees are not listed.

The only other conceivable argument for a fee ban is that such charges put small banks at a disadvantage because they can't create similarly large (free) ATM networks for their depositors. But there are plenty of other ways to get cash for free (including debit cards) and plenty of other reasons to choose a small bank (including more personal service).

Indeed, advocates of fee bans obviously think consumers are stupid. *USA Today* whined that "big banks, hiding behind their high ATM surcharges, tend to charge higher fees and pay less interest than smaller institutions." Actually, this demonstrates that financial institutions can and do offer competing packages of benefits. If customers prefer bigger ATM networks to lower fees, who are the *USA Today* editors or Santa Monica city councilmen or San Francisco voters to deny them?

Anyway, small banks have no claim to public aid because they are small. The ATM prohibition is an attempt to force larger banks to underwrite their smaller competitors by giving customers of the latter free access to an ATM network that is expensive to introduce and maintain.

The campaign to ban ATM fees is yet one more attempt to find the free lunch that never exists. □

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000

Spam, Spam, Spam, and Spam

by Gary McGath

Electronic mail on the Internet has revolutionized communications. It allows people to communicate with others far away without playing "telephone tag" or running up expensive long-distance bills. It lets people distribute messages to large mailing lists with a tiny fraction of the cost and time it would take to send paper mail.

But every advance has its dark side as well. The same technology that permits people to get the mail they want also permits others to send them mail they don't want. Such mail is known as "unsolicited commercial e-mail" (UCE), "unsolicited bulk e-mail" (UBE), or, most commonly, "spam." This term can be traced back to a Monty Python comedy sketch about a restaurant that serves Spam, Spam, Spam, Spam, and Spam, the idea being that it's always more of the same. ("SPAM," with all capitals, is a trademark of Hormel, but it hasn't contested the new use of the lower-case term.)

UBE is economically different from other types of unsolicited promotions because its incremental cost is much lower. Mailing a flyer costs money for paper, printing, and postage. Telephone marketing, even with an unlimited service line, requires the time of an operator and the use of the phone line for however long it takes to make the call. But with bulk e-mail, the incremental cost of sending out another copy is only a few bytes of data storage for the recipient's address—that is, next to nothing. The cost falls on the recipients and their service providers, as their computers receive thousands of copies of the original message.

Gathering of Addresses

Mailers gather publicly posted addresses, typically on newsgroups and World Wide Web pages. Because of the low incremental cost, there is little incentive to cull lists by degree of interest or even to remove undeliverable addresses. Marketers of mailing lists offer these addresses at low prices; one offer sent to me (by UBE, of course) touted a million addresses for $700.

At these prices, and at a small monthly cost for an Internet account, advertisers need only a tiny rate of return to pay back their investment. Lots of businesses would, all else being equal, be eager to get into the act. The number of advertising messages that users receive would quickly become a serious burden (and already has for some people). The mail storage capacity allocated to an account might be exceeded, causing the deletion of important mail; the time needed to download the messages and then to separate out the junk mail can also become a major inconvenience. In addition to costs to the end user, the costs of transmitting and storing all these additional messages places a burden on Internet service providers (ISPs), driving up the costs of accounts and increasing the delivery time of

Gary McGath, a software engineer and freelance writer, is a former editor of the Thomas Paine Review.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

the average message. The mailers' slogan, "Just hit delete," isn't a satisfactory solution to the problem.

The burden doesn't fall equally on all recipients. People who keep their addresses secret from all but a select group of associates can avoid nearly all UBE. Those who post their address in public discussion groups or on their Web pages will quickly find themselves getting mailings on everything from miracle fat-reducing pills to schemes for making $50,000 a month. Thus people are often intimidated into not publicly disclosing their e-mail address, or they take out a second, unpublished address. Some people change their addresses simply because their old ones are on so many junk-mail lists.

Estimates of the costs imposed by UBE vary widely. In a widely publicized study released last June, Bright Light Technologies claimed that the annual cost to a large ISP through lost customers could be in the millions of dollars; others dispute that figure. Nearly everyone in the industry, though, agrees that the cost is significant.

Government to the Rescue?

Where does this leave us? Does the government have to step in and limit what can be mailed? Some would say yes. A widely supported organization called CAUCE (Coalition Against Unsolicited Commercial Email; www.cauce.org) describes itself as "an ad hoc, all volunteer organization, created by Netizens to advocate for a legislative solution to the problem of UCE (a/k/a/ 'spam')." In 1997 CAUCE tried to amend the federal statute outlawing junk faxes to also prohibit junk e-mail.

H.R. 3113, the Unsolicited Electronic Mail Act of 1999, which CAUCE supports with some reservations, would require the Federal Communication Commission to maintain or contract out a list of the names and e-mail addresses of all people who wish not to receive "unsolicited commercial electronic mail, unsolicited pandering electronic mail, or both." Sending such mail to people on the list would be prohibited.

This type of legislation has several problems. It establishes categories of mail by content, giving different rights to senders of mail depending on whether it is deemed "commercial," "pandering," or neither. This raises First Amendment issues. Bulk-mailed religious tracts and political manifestos would be unaffected by such a law, even though they impose the same burdens as other UBE. Also, since nearly everyone would want to escape from such mailings, the bill would create a massive, publicly available database of people's names and e-mail addresses. Non-U.S. bulk mailers beyond the reach of our laws might even use it as a mailing list.

But legislation is hardly the only solution to the UBE problem. Where there is a strong market demand—in this case, a demand not to receive something—businesses work to fill it. UBE has proven to be an ineffective advertising medium for legitimate businesses. The antagonism it arouses strongly outweighs any positive response. As a consequence, the amount of cold UBE that legitimate businesses send is negligible. (There is controversy over gray areas in which an advertiser and recipient have had prior contact, but that is another matter.) The market has averted the doomsday scenario in which every business in the world sends e-mail to every account in the world. Legislation could actually defeat the market's effect by giving the appearance of acceptability to bulk mailers who follow government-approved procedures.

Today nearly all service providers have policies prohibiting the transmission of unsolicited bulk mail. Those that don't or that are lax in enforcing their policies find that other sites will not accept mail from them. Junk e-mail today comes primarily from fly-by-night operations, promoters of dubious schemes, and outright frauds who open accounts just long enough to pour messages into a hundred thousand mailboxes.

Technology is part of the market solution. Normal mail on the Internet is conveyed by a protocol called SMTP (Simple Mail Transfer Protocol). SMTP was created in the days when the Internet was a government-subsidized project used mostly by educational institutions; it contains no protection against forgery. Bulk mailers have taken advantage of

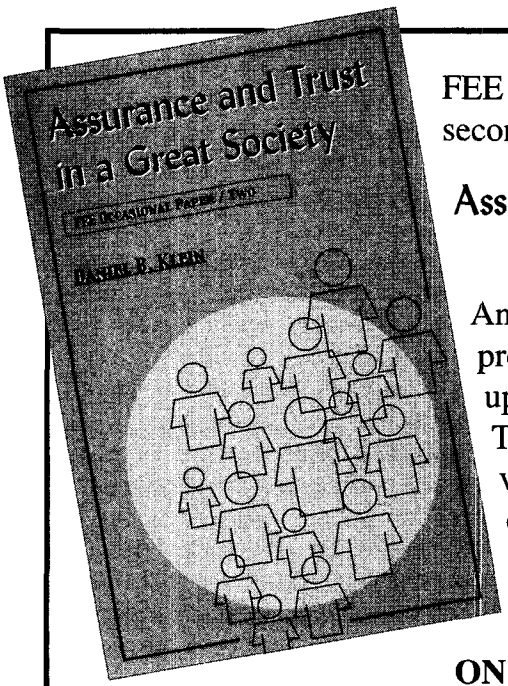
LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

that to falsify the origin of their mail; if recipients can't tell where the mail came from, they can't inform the sender's service provider of the abuse.

To solve this problem, creators of mail-server software have improved their products to make it more difficult to send forged mail and easier for knowledgeable readers to determine its actual point of origin. Others have provided downloadable software and Web sites that permit even unskilled users to determine the likeliest origin of the mail and send in a report. Because many Internet users don't "just hit delete," but take the time to send in reports of UBE, the account of the typical "spammer" has a short life. Many service providers offer filtering services that eliminate a significant portion of UBE before the recipient sees it; having such a policy provides a marketing advantage.

In addition, existing legal protections can be applied against fraudulent UBE. Because the Internet is new, legal precedents are often lacking. But this is changing. America Online has won a number of lawsuits against bulk mailers who sent mail with forged AOL return addresses; others have had similar successes. If there is a need for new legislation, it is only in clarifying how existing concepts of fraud and theft of resources apply to new technologies.

The Internet has been successful largely because it is relatively unregulated. Spam is no justification for new regulations. Technology can stop the flow of abusive mail from wherever it might come. □



FEE is pleased to announce the arrival of the second in our series of Occasional Papers:

Assurance and Trust in a Great Society
by Professor Dan Klein

An intriguing look at the ways markets promote and reward relationships built upon trust.

This collection of four essays provides vigorous counterarguments to those who claim that government alone is capable of policing against fraud and unfair dealing.

ON SALE NOW FOR $5.95
Plus shipping and handling

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000

Does Insanity "Cause" Crime?

"The madman is not the man who has lost his reason. The madman is the man who has lost everything except his reason."
—GILBERT K. CHESTERTON

For 300 years we have sidestepped confronting the truth about human desperation and depravity, and the horrors the desperate and the depraved can inflict on us and themselves.

In November 1999, Andrew Goldstein, a man with a long history of psychiatric encounters, was tried for murdering a young woman named Kendra Webdale by pushing her under a New York subway train. The defense was insanity. The jury was unable to agree on a unanimous verdict. Goldstein will be retried this spring.

There was no dispute that Mr. Goldstein pushed Ms. Webdale to her death. Nor was there dispute about what, regardless of the jury's verdict, was to be Mr. Goldstein's fate for the foreseeable future: he would be deprived of liberty (by being incarcerated in jail, a mental hospital, or a hybrid institution called a "forensic facility").

The problem is that whenever a person factually guilty of committing a serious crime pleads insanity, the jury is asked to answer an intrinsically nonsensical question, namely, what "caused" the defendant to commit his wrongful act: his self or his mental illness? If the former, then he is a guilty victimizer. If the latter, then he is an innocent victim (of insanity). I say the question is nonsensical because regardless of whether a person is (deemed to be) sane or insane, he has *reasons, not causes,* for his action. If we regard the actor's reasons as absurd or "crazy," we call him insane or mentally ill. However, that does not prove that an alleged condition ("insanity" or "mental illness") caused him to commit the forbidden act. In short, the insanity defense combines and conflates two problematic elements about "insanity": (1) what is "it" (as a phenomenon or disease)? and (2) does it cause and excuse bad behavior?

Although no one can define insanity, nearly everyone believes that he can recognize it "when he sees it." Still, the question remains: What is "it"? In principle, this question ought to be debatable. In practice, it is not: all socially recognized authorities agree that insanity is a brain disease.

For the sake of clarifying the issue before us, let us admit that (false) claim. In that case, insanity is similar, say, to Parkinsonism or a stroke, brain diseases diagnosed and treated by neurologists. A brain disease may, indeed, be a cause. But a cause of what? Typically, of a behavioral deficit, such as weakness, blindness, paralysis. No brain disease causes complex, coordinated behaviors, such as the

Thomas Szasz, M.D., is professor of psychiatry emeritus at SUNY Health Science Center in Syracuse, New York. He is the author of The Myth of Mental Illness.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

crimes committed by Andrew Goldstein or John Hinckley, Jr.

The insane person is, after all, a person, a human being. Only legal tradition and psychiatric-professional self-interest, not facts or logic, compel the law to frame the jury's task as a choice between deciding whether an insane defendant is bad or mad — guilty (by reason of free will) or not guilty (by reason of insanity). If a "mad killer" is sick, he could—like an HIV-infected killer or a tubercular killer—be imprisoned for his crime and "treated" for his illness in prison.

Millions of people are said to be mentally ill or insane. Not all of them commit crimes. Although a mad person such as Mr. Goldstein is regarded as being mad much of the time or even all of the time, he kills only some of the time. When a mad person kills someone—just as when he petitions a court to be released or eats his dinner—he does so because he decides to do so. Hence, if the madman commits a crime, justice demands that we take him seriously and punish him for his deed.

From Solution to Problem

The insanity defense, as we know it, is a relatively new cultural invention. I believe it is not possible to understand the problems it causes unless we understand the problems it solved in the past and solves today.

The "crime" that led to the creation of the insanity defense was not murder, but a deed long considered even more heinous, namely self-murder, or suicide, punished by both ecclesiastic and secular penalties: the suicide was denied religious burial and his estate was forfeited to the Crown's Almoner.

Because punishing suicide required doing grave harm to innocent parties—that is, to the suicide's children and spouse—men sitting on coroner's juries eventually found the task to be a burden they were unwilling to bear. However, prevailing religious beliefs precluded repealing the laws punishing the crime. The law now came to the rescue of the would-be punishers, offering them the option of finding the self-killer *non compos mentis* and hence not responsible for his deed. In the eighteenth century, it became a matter of routine for juries to arrive at the posthumous diagnosis that the suicide was insane at the moment he killed himself. (The criminal law against suicide was repealed only in the nineteenth century, by which time it had been replaced by mental health laws.)

The celebrated English jurist William Blackstone (1723–1780) recognized the subterfuge and warned against it: "But this excuse [of finding the offender to be *non compos mentis*] ought not to be strained to the length to which our coroner's juries are apt to carry it, viz., that every act of suicide is an evidence of insanity; as if every man who acts contrary to reason had no reason at all; for the same argument would prove every other criminal *non compos*, as well as the self-murderer." It was too late. By validating the fiction that suicides could, *post facto*, be *found* to have been *non compos mentis*, the law had crafted a mechanism for rejecting responsibility—the criminal's for his deed, the jury's for its duty—and, aided by the medical profession, wrapped the deception and self-deception in the mantle of healing and science.

We must keep in mind that the impetus for excusing self-murder did not come from its ostensible beneficiaries, the victims of the law against suicide. Clearly, it could not have come from them: the self-killer was dead; his family, bereft of means and reputation, was powerless. Instead, the impetus came from those who needed it and had the political clout to make law and medicine embrace it—judges and lawyers, coroners and mad-doctors. Coroner's juries and judges could thus evade the burden of having to impose harsh penalties on the corpses of suicides and the widows and children they left behind; and physicians could pride themselves for saving innocent persons from suffering for the sin-crimes of "insane" self-killers.

The result of the practice of routinely excusing suicides of their sin-crimes by viewing them as insane was that persons suspected of being suicidal began to be incarcerated in insane asylums. Soon that, too, became a routine practice and reinforced the belief that persons who kill themselves or others are insane, and that the insane are likely to kill themselves or others. □

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000

The Stakeholder Fallacy

by Norman Barry

As the saying goes: "There is more than one way to skin a cat." And former collectivists, embarrassed by the dismal failure of economic planning to provide any kind of life for the people unfortunate enough to live under it, have been quite creative in discovering new ways to undermine capitalism. Some of these efforts come from *soi-disant* philosophers who, in search of employment, have discovered "business ethics." However profitable to the practitioners this is, it is in no sense an entrepreneurial discovery. Company directors, stockholders, and assorted "fat cats" (unskinned) are daily bombarded with demands for business to be "socially responsible"; it is a request that many managers are only too happy to satisfy: after all, working for "society" is surely more morally pleasing and less demanding than working for the shareholder.

The business ethicists' current fad is to demand that the traditional profit-seeking corporation be transformed into a curious (and unspontaneous) business enterprise consisting entirely of stakeholders. The shareholders, the people who put up the capital and bear most of the risks, are apparently only one part of this heterogeneous collection. As prominent American stakeholder theorists William M. Evan and R. Edward Freeman assert: "The reason for paying returns to owners is not that they 'own' the firm but that their support is necessary for the survival of the firm."[1] The ultimate purposes of an enterprise, and the decisions made within it, should be determined jointly by all the groups who play a part in its functioning. These groups—primarily workers, suppliers, residents of the community in which the enterprise is located, and bankers (who in some economic regimes, such as Germany and Japan, are also equity holders)—should have an equal share in all decisions that the firm has to make. Indeed, there is really no limit to the groups that might claim to be stakeholders, since almost anyone can assert at least a nodding acquaintance with the activities of the business. The annual reports of many publicly quoted companies are prefaced by soothing references to what they have done for their organization's myriad stakeholders. Leading "New Democrats," such as former Labor Secretary Robert Reich, find the allure of stakeholderism quite irresistible.[2]

But it is not difficult to show that behind the anodyne language of stakeholderism lies a sinister doctrine indeed. It is an idea and practice, the ideologues claim, that is perfectly compatible with capitalism, but in fact it undermines the defining feature of that economic system: the exclusive rights of ownership. What the doctrine amounts to is the democratization, or even worse, politicization, of what is essentially an individualistic economic institution. It is no coincidence that stakeholder groups are frequently called

Norman Barry is professor of social and political theory at the University of Buckingham in the UK. He is the author of Business Ethics *(Macmillan, 1998).*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

"constituencies" in the new descriptions of the firm.[3]

Anglo-American Capitalism and the Stakeholder Model

In the conventional structure of the Anglo-American firm, the rights to action are all ultimately derived from property relationships: there are residual rights, control rights, and decision rights. The shareholders (as residual claimants) are entitled to any surplus that remains after all operating costs have been paid, and therefore they possess the first type of rights. Control rights are the rights to appoint managers, and these are delegated to directors by the owners. Decision rights are exercised in the day-to-day activities of managements. Although the shareholders ultimately determine the rights structure, the familiar separation between ownership and control means that they will not directly exercise decision rights. Those are exercised by the managers under the guidance of the directors.

Undoubtedly there is authority in the traditional firm. Decisions have to be made that are not the results of political-style negotiations between groups, but rather are the judgments of personnel driven by the objective of maximizing long-term owner value.[4] The theoretical explanation of all this is in Ronald Coase's famous 1937 article in which he demonstrated how the bilateral contract between employees and owners replaced the benign, multilateral, and instantly renegotiable contracts of pure market society; the excessive transactions costs involved in the latter made it an uneconomic way of doing business.[5]

Of course, the firm does not have to be organized like this. In less individualistic capitalist economies, the drive for shareholder value is less insistent and interests other than those of the owners are allowed, either by law or practice, an influence on corporate decision-making. For example, Germany, has had worker co-determination since the early 1950s. This system makes trade union membership of the supervisory board of a public company obligatory (although ultimate residual rights are exercised by the owners, for example, in the event of a takeover, which rarely happens). And Japan, despite its superficial resemblance to the Anglo-American model, has in practice developed a system with derisory residual rights for the owners and great power for the managers.[6]

However, the classical-liberal model has been immensely successful, largely because of its admirable flexibility; Japan has been mired in recession for a decade, and Germany is suffering serious capital flight as owners look for more propitious venues for their property than the rigid and unresponsive industrial structures at home. Germany has, however, slowly been adopting Anglo-American business methods in the past few years. As usual, the intellectuals are behind the times.

The stakeholder theorists want to replace a successful production method with one more in keeping with their communitarian inclinations. For them, it is not the property invested that should determine who should exercise decision-making rights but the roles that particular groups play in the organization. Thus in plant relocation, all sorts of affected groups—for example, employees, residents of the area where the firm is currently situated, and inhabitants of the possible new destination—are to be taken into account, in addition to the profit-maximizing goals of the owners. Perhaps remuneration should be a function of group pressures (that is, "social" justice) as well as market value, and severance (if allowed at all) might be negotiated on terms dictated by trade unions.

Most important, takeovers that threatened "communities" (entrenched groups) would most likely be forbidden or strictly regulated in a stakeholder society. In the Anglo-American model this would be catastrophic, since the takeover is the only method by which potential managements can be disciplined. In the "arm's length" relationships of an essentially anonymous system, there are no intimate social bonds that can prevent opportunism in this type of capitalism.

There is always the agency problem in a business practice that embodies an advanced separation between ownership and

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

control: how do the owners prevent the self-aggrandizing managers' surreptitiously asserting residual rights? Ironically, left-biased Hollywood movies portrayed accurately this permanent feature of Anglo-American business; we all remember Gordon Gekko's brilliant speech to the stockholders in *Wall Street* (the similar one in *Other People's Money* is perhaps even better). Maybe the more communitarian capitalist economies prevent managements' shirking their contractual duties and engaging in self-aggrandizement by enforcing a complex notion of "trust," although it is hard to see how that method is at all effective in Anglo-American-style individualism. But it is noteworthy that the anti-takeover statutes passed by the American states in the wake of the amazingly successful 1980s corporate restructuring process were promoted by stakeholder groups using communitarian language. In fact, nonshareholding managements stood to lose most from the wealth-creating activities of the "predator."

Decision-Making in the Stakeholder Model

There is a very simple problem that lies at the heart of all stakeholder theory: how can the potentially conflicting demands of the various stakeholder groups be coordinated? There is no problem here in the Anglo-American model (unencumbered by stakeholders), for although the participants in an enterprise will have different views on how it should be run, what investments to make, what divestitures to effect, and so on, they are ultimately harmonized and put to the test of experience through the price mechanism. That is not the case with a stakeholder corporation, for there is no common scale of values, no surrogate for the price mechanism, but only incessant bargaining between, in essence, political groups that will likely have no immediate financial interest in the company.

Despite openly declaring that "The very purpose of the firm is to serve as a vehicle for stakeholder interests," Evan and Freeman are at least aware of this problem, though their proposed solution to it is laughable.[7] To resolve the conflicts between competing stakeholder groups, they recommend the appointment of a "metaphysical director" to adjudicate between rival groups.[8] This is, of course, self-aggrandizement by philosophers (well, they aren't paid very much) and no solution to the problem. Any such person will simply divert income to himself up to the point at which the viability of the firm is threatened. Anyway, who would ever invest in a firm whose goal was not to make money for its owners but to satisfy disorganized groups and various social demands?

Maybe this does not bother Evan and Freeman; their article is subtitled, "Kantian Capitalism," and we know that the rightness or wrongness of actions for Kantians in no way depends on beneficial consequences (even though, like most business moral philosophers, Evan and Freeman insist that corporate ethics are profitable).

A Meaningful Concept of the Stakeholder

None of the above is meant to imply that the idea of the stakeholder is completely useless. It certainly has some function in business. It is quite likely that long-term owner value will not be advanced if labor is treated as an easily disposable factor of production, to be dismissed as soon as a downturn in business activity occurs. This is especially true of "firm specific" human capital, workers whose skills are only appropriate for one particular company. They are the people most vulnerable in the event of a takeover. The firm needs a good reputation, and if it is to prosper it will have to attract labor in the future; its prospects will be harmed if it acquires a reputation for cavalier treatment of its staff.

Again, it will not be to a firm's long-term advantage if it dispenses with a reliable supplier just because an alternative turns up with a slightly lower price (offering, perhaps, only a temporary advantage). And of course it will pay a company to establish good relationships with the community in which it is situated.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

But this has nothing to do with ethics; it is simple prudence. The contemporary theorists of the doctrine, however, are not talking about good business practice. They are objecting to the property-rights structure of the modern corporation and renouncing its economically necessary authority relationships. The alleged equality between the various stakeholder groups is potentially a deadly constraint on profitability. As we know, if everybody owns everything, then nobody owns anything, and no one has an incentive to preserve and expand economic value. Similarly, if everybody is responsible for decision-making, then no one is, and no one is properly accountable. The stakeholder prescription is singularly inappropriate to the Anglo-American capitalism that still functions in a more or less anonymous world where its agents are held together by little more than the impersonal price mechanism and the rules of competition.

Perhaps stakeholder capitalism is more appropriate for closely knit societies, or economies in which transactors do not deal at arm's length, but participate in a common enterprise. Indeed, such arrangements significantly reduce transactions costs since the individualistic (and often takeover-driven) Anglo-American business world is compelled to spend a lot of resources on lawyers and financial intermediaries. Perhaps there really is a lack of trust in this world. But it is the world of the present and the future, a world characterized by highly mobile labor and quicksilver capital. It is one that certainly requires rapid responses to ever-changing economic circumstances.

The stakeholder theory, despite its meretricious, supposedly modern language, is really rather reactionary. It belongs to the nineteenth-century world of large-scale industry, big unions, more or less unchanging production techniques, and stagnant social relationships. It is the world originally described by Coase. But transactions costs are changing, and it is now becoming efficient to use market methods *within* the firm. Entrepreneurship does take place there. Future work arrangements will include people working from home and using the Internet. The corporation may become a thing of the past. There will then be no more work for business ethics writers.

It is curious that the antiquated doctrine of stakeholding should have such an appeal at a time of rising stock values, newly emerging companies, a revitalized individualism, and rapid social change.[9] It is little more than a sanitized version of socialism. Its contemporary irrelevance can be seen from the fact that it has a declining appeal, especially to those economies in which it began, Germany and Japan. □

1. W. Evan and R. Freeman, "A Stakeholder Theory of the Modern Corporation: Kantian Capitalism," in T. Beauchamp and N. Bowie, *Ethical Theory and Business*, 4th edition (Englewood Cliffs, N.J.: Prentice Hall, 1993), p. 82. For a critique, see Norman Barry, *Business Ethics* (London: Macmillan, 1998), chapter 4.
2. Robert Reich, "The New Meaning of Corporate Social Responsibility," *California Management Review*, 1998, pp. 8–17.
3. See J. Kuhn and D. Shriver, *Beyond Success* (London: Oxford University Press, 1991).
4. E. Sternberg, *Just Business* (London: Little, Brown, 1994), chapter 3.
5. Ronald Coase, "The Nature of the Firm," *Economica*, 1937, pp. 386–405.
6. Barry, pp. 80–83.
7. Evan and Freeman, p. 82.
8. Ibid.
9. See W. Beaver, "The End of the Stakeholder Model?," *Business Horizons*, 1999, pp. 8–12.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000

Regulatory Extortion

by Thomas J. DiLorenzo

In 1978 Michael Jensen and William Meckling, writing in the *Financial Analysts Journal*, offered an extraordinarily gloomy prediction for the future of capitalism: "The most spectacular period of economic growth in our history is over," they wrote, because "government is destroying two vital instruments of that growth—the system of contract rights and the large corporation."[1] Constitutional and electoral constraints on political plunder have proven ineffective, Jensen and Meckling wrote, as the courts, politicians, and regulators have revoked or attenuated property and contract rights and have attacked freedom of association as well, "especially in the civil rights arena."[2]

With regard to the stock market, Jensen and Meckling forecast that because of the instability of property rights caused by government intervention,

> investors have become much less certain that any contract they enter into now will be subject to the same rules and regulations in the future. An early consequence of the erosion of property rights will be a reduction in the capitalized values of corporate securities, with many corporations able to remain in business only so long as they can finance their operations from internally generated cash flow or [government] subsidy.[3]

As of 1999 the Dow Jones Industrial Average was about 15 times higher than it was in 1978, when Jensen and Meckling issued their dire warnings. But this doesn't mean that they were wrong about the effects of the American regulatory state on stock prices. The Dow Jones average might be even higher yet were it not for the large degree of governmental control of the means of production that is exercised through regulation. And the stock market is surely much more volatile because of the great uncertainties created by regulation. Overzealous regulators may even cause the market to crash. As discussed below, it was proposed regulation and taxation of corporate takeovers that likely precipitated the 1987 U.S. stock market crash.

Political Entrepreneurship

Although regulators are usually blamed for the economic and social harm inflicted by regulation, it is politicians who are ultimately responsible. The U.S. Department of Labor may enforce the minimum-wage law, for example, but it is Congress that passed it. Regulation is just another form of pork-barrel politics whereby politicians dispense regulatory favors to special-interest groups, at the expense of the rest of society. Corporations are particularly susceptible to attacks by

Thomas DiLorenzo is a professor of economics at Loyola College in Baltimore, Maryland. This article is based on a presentation prepared for the Ludwig von Mises Institute's conference, "Austrian Economics and the Financial Markets," last September in Toronto.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

politicians pandering to special-interest groups because corporate ownership is relatively invisible, widely dispersed, and politically incohesive, as a rule. Moreover, the stock market is so volatile and complex that the owners of corporations (shareholders) would find it difficult, if not impossible, to attribute declines in their asset values to specific government actions. In contrast, special-interest groups are, by definition, more focused and politically well organized.

Politicians are not merely passive bystanders who go on "listening tours" of their constituencies and then faithfully enact the kinds of laws that the public wants. They are "entrepreneurs" who are experts at either creating genuine economic and social crises or the *perception* of crises, and then offering their "services" in resolving the crises. The most obvious example of this phenomenon is war. War provides politicians with myriad rationales for controlling and regulating economic activity, and few of the controls are abandoned once the war is ended.[4]

Of course, politicians never admit that *they* are the source of the problems. They usually blame corporations in particular, or capitalism in general. Hence, we witness a constant recitation of "crises" manufactured by the state and blamed on capitalism. In the agricultural sector, for example, it has been government policy ever since the Hoover administration to simultaneously pay farmers to grow more (with price supports) *and* less (with acreage allotments), and to subsidize thousands of failing farm businesses with farm welfare in the form of low-interest loans and grants. The agriculture industry is thereby made weaker and more volatile, which of course is reflected in the prices of publicly traded corporations in agriculture and agriculture-related industries. Government intervention is the source of these problems, but the blame is always placed on "agricultural markets."

The U.S. Department of Commerce publishes fraudulent poverty statistics to make poverty look worse than it actually is and to "justify" such economically destructive policies as increases in the minimum wage or tax increases for the ostensible purpose of redistributing income to the "poor."

In the environmental arena, countless capitalistic bogeymen have been blamed for everything from cancer to the destruction of the planet. This list of phony environmental scares is so long that any rational, thinking person should routinely assume that *everything* the organized, political environmental organizations say is a lie.

The federal government has been forecasting an impending energy crisis ever since the dawn of the oil industry—roughly 1866. In that year the U.S. Revenue Commission warned that the nation may run out of oil at any moment. In 1885 the U.S. Geological Survey forecast no chance of oil's being discovered in California; some ten billion barrels have been pumped from that state since then. By 1914 the U.S. Bureau of Mines was predicting that only 5.7 billion barrels of oil were left; more than 50 billion barrels have been pumped since then. In 1947 the U.S. Department of State warned that "sufficient oil cannot be found in the United States"; in 1948 more than 4 billion barrels were found—the largest discovery in history up to that point and twice the volume of U.S. consumption. In 1951 the U.S. Department of Interior forecast that oil reserves would last only until 1964.[5]

All of these gloomy (and false) forecasts were (and are) accompanied by proposals for more government control of the energy industry to "assure" a more adequate rate of development.

The fundamental effect of this regulatory-propaganda regime on stock markets is to convince more and more investors that the right of corporate managers to use the assets of corporations in the best interests of stockholders and creditors (that is, to maximize profits) is tenuous, if not abrogated completely. The politicization of corporate decision-making via regulation causes an overall decline in capital values as corporate decisions become more and more designed to pander to the whims of politicians and bureaucrats rather than satisfying consumers and earning income for shareholders.

Government regulation is often a form of

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

legalized extortion. For example, federal regulators routinely show up at corporate headquarters and accuse a corporation of being out of compliance with regulations that no human could possibly be in compliance with. The EPA requires that corporations which handle "hazardous materials"—which even includes Windex, according to the EPA—must keep a written record of where each and every container is located at every moment. Former New York state environmental protection commissioner Thomas Jorling described this practice as "a kind of extortion."[6] EPA regulators will enter a corporate office and impose huge fines on corporations that could not possibly maintain the EPA's huge paperwork burden even if they wanted to. Threatened criminal indictments assure payment of the fines.

In a 1997 book, Cornell University law professor Fred McChesney argues that blackmail and extortion are *inherent* features of the modern regulatory process. In short, political "entrepreneurs" threaten legislation and regulation that will either impose price controls or increase costs (both of which would reduce profit margins) unless the targeted companies and industries compensate the politicians with campaign contributions or other kinds of private payoffs (including speaking honoraria, jobs for relatives, and subsidized travel to luxurious vacation resorts).

Politicians call legislation that is intended to extort campaign contributions from a business or industry "milker bills" or "cash cows." As explained by one California legislator, a politician "in need of campaign contributions, has a bill introduced which excites some constituency to urge [the legislator] to work hard for its defeat (easily achieved), pouring funds into his campaign coffers."[7]

Another name politicians have given to such legislation is "juicer bill," since they are designed to "squeeze" cash out of corporate coffers in return for not harming the corporation with proposed legislation and regulation. So-called "fetcher bills" are also said to be capable of "fetching" gobs of campaign cash.

Examples of Political Extortion

One recent example of a proposed regulation that seems to have been designed purely to fetch perpetual campaign contributions is the battle over reducing the legal blood-alcohol content (BAC) level from .10 to .08. The federal government's Office of Substance Abuse Prevention has declared that its goal is to eventually have .04 as the legal limit, which can be attained by an adult male who consumes one or two beers. Congress failed to pass such a law in 1998; the law that it did pass, however, creates a slush fund of highway grant money that can be used to bribe states into passing laws that reduce the legal BAC level. The law is to be renewed *every year*, guaranteeing that the alcoholic beverage industry will be forced to make campaign contributions indefinitely to defeat this neo-prohibitionist legislation.

In 1992 Congress authorized the Federal Communications Commission to impose price controls on cable television. Ever since then, the cable industry has poured millions of dollars of campaign contributions into Washington annually in an apparently fruitless effort to eliminate the controls.

One of the more notorious examples of political blackmail in recent years involved the Clinton administration's proposals to impose price controls on doctors, hospitals, and the pharmaceutical industry as part of its failed plan for socialized medicine. Once price controls were proposed, reported the *New York Times*, members of Congress and the president were "receiving vast campaign contributions from the medical industry, an amount apparently unprecedented for a non-election year. While it remains unclear who would benefit and who would suffer under whatever health plan is ultimately adopted, it is apparent that the early winners are members of Congress."[8]

Representative Jim Cooper, who proposed legislation that was slightly less onerous than Clinton's, received nearly $1 million in campaign contributions in the first four months of 1994; overall, campaign contributions in 1993 were about one-third higher than in the previous non-election year of 1991.[9] It was also widely reported at the time that the handlers of Hillary Clinton's not-so-blind trust were selling her pharmaceutical stocks short every time she made a highly publicized speech

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

demonizing the pharmaceutical industry, which she did quite often. During the Clinton health plan fiasco of 1993–94 the value of pharmaceutical stocks dropped by over $40 billion, according to one account.[10] After the industry poured millions of dollars into the coffers of Washington politicians the price-control plan was defeated.

In his book *In Defense of the Corporation*, Robert Hessen documents how Ralph Nader has long engaged in the same practice as the first lady—shorting the stocks of companies that his numerous think tanks and organizations routinely demonize with highly publicized "studies" alleging corporate wrongdoing.[11] The "tobacco settlement" reached by the state attorneys general, the federal government, and the companies might well be considered to be the Mother of All Political Shakedowns. In return for being allowed to stay in business, American tobacco companies are being forced to pay almost a quarter of a billion dollars to trial lawyers and federal, state, and local governments. The media have already begun reporting on how the initial installments are being spent on anything and everything by state and local governments, and not only "health-care costs," as was promised.

Even this record may someday be broken, however, if the government succeeds in destroying the Microsoft Corporation. Just a few years ago the *Washington Post* was writing sneering articles about how naïve Bill Gates was for believing he could focus his energies solely on producing better computer products without being a "player" in Washington, that is, caving in to the Washington establishment's legalized extortion racket. Since then, Gates has hired dozens of Washington lobbyists and lawyers and has spent the required millions in campaign contributions.

Regulation is perhaps most effectively used as a tool of extortion when it threatens to sharply increase the costs of doing business, which it always does. Again, the game is for politicians to propose regulations that would drastically increase the costs (and subsequently reduce the profits) of successful companies with "deep pockets." For example, the banking industry spent millions in campaign "contributions" to stop a 1982 requirement that they withhold taxes on interest and dividends—a paperwork nightmare for the banks. In 1983 and 1984 the life insurance industry spent more than $2 million to defeat legislation that would have banned the granting of gender-based rates and benefits.

Perhaps the most egregious example of regulatory blackmail is enforcement of the so-called Community Reinvestment Act (CRA). The CRA was enacted in 1978 under a patently false pretense—that banks made fewer loans to residents of low-income neighborhoods not because there were fewer creditworthy borrowers there, but because of allegedly pervasive "discrimination" against the primarily black residents of those neighborhoods. Banks do—and should—"discriminate" against less creditworthy borrowers, but in doing so they run the risk of regulatory extortion.

An entire industry of sometimes federally funded "community groups" has sprung up, with names like Center for Community Change and Association of Community Organizations for Reform Now (ACORN), which essentially extort money from banks with the following ruse: Whenever a bank proposes a merger, expansion, or building of a new branch, it is subject to regulation by the Federal Reserve, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. If *anyone* files a complaint with any of these agencies accusing the bank of making too few CRA loans, the merger or expansion is halted. So-called community groups frequently lodge such complaints and do not withdraw them until the banks give *them* or other groups they designate large sums of money, sometimes in the tens of millions of dollars. The Neighborhood Assistance Corporation of America (NACA), led by self-described "urban terrorist" Bruce Marks, has "won" loan commitments totaling $3.8 billion from Bank of America Corp., First Union Corp., Fleet Financial Group, and others. That money is lent to borrowers favored by Marks, and his organization usually gets a lump-sum fee or a percentage of each loan.[12] NACA plans to operate in all 50 states by 2001, when

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

it expects its annual budget to be in the $80 million range.

Regulation and the Stock Market Crash of 1987

Economists Mark Mitchell and Jeffrey Netter have provided powerful evidence that regulatory sneak attacks precipitated the stock market crash on October 19, 1987, when the Dow Jones Industrial Average fell 508 points (22.6 percent).[13] Their thesis is that proposed changes in the tax treatment of corporate takeover transactions, which would have made such transactions much more costly, triggered the crash.

It is important to recognize the importance to the economy of the market for corporate control, or the takeover market. This market is a keystone of any capitalist economy, for it is the very means by which capital is continually reallocated to those who will make the best use of it. A vital and free capital market, Ludwig von Mises wrote, is the keystone of capitalism and the one thing that most distinguishes a capitalist economy from a noncapitalist one. Unfortunately, that is also why politicians are forever proposing more and more regulatory control of it.

Laws and regulations that restrict corporate takeovers are protectionist. In a corporate takeover a group of investors has determined that a particular company is being mismanaged. They seek, through a proxy battle or other means, to take over control of the board of directors and, subsequently, of management. They may fire some or all of the poorly performing managers, replace them with better ones, and make more profit for themselves and the other shareholders.

No one has perfect foresight, so many takeovers do not work out. But nevertheless, the only way to learn who can make the best use of corporate resources is to allow the free market to tell us, including the free market for corporate control.

Laws and regulations that would restrict takeovers or make them prohibitively costly are invariably the result of lobbying efforts by incumbent managers who have bribed politicians into enacting the protectionist provisions, which only benefit the incumbent managers at the expense of their shareholders and customers.

In early October 1987 the Congress waged a full-scale assault on corporate takeovers by passing several important changes in the tax code.[14] Mitchell and Netter calculated that these changes would have reduced the value of acquiring a company through a takeover by about 25 percent; that would in turn cause a decline in the stock price of the acquiring company. Typically, the stock price of an acquiring company increases 25 to 35 percent as the result of a takeover. Moreover, such a dramatic anti-takeover bill would have reduced stock prices overall by generally weakening the market for corporate control, a major source of efficiency in capital markets.

The Regulatory Attack on Microsoft

Microsoft's critics claim to believe that what is bad for Microsoft (an antitrust prosecution) is good for the rest of the computer industry and vice versa because of Microsoft's allegedly "exclusionary" practices. Microsoft is supposedly "a threat to everybody in the industry," according to Alan Ashton, president of WordPerfect, which has lost almost all of its market share to Microsoft Word.

In a forthcoming article in the *Journal of Financial Economics,* Thomas Hazlett and George Bittlingmayer expose this as a myth.[15] The authors surveyed all *Wall Street Journal* articles from 1991 through 1997 announcing the investigations and litigation and gauged the reaction of the stock markets to it. Categorizing all news stories about the regulatory assault on Microsoft as "positive," "negative," or "ambiguous," they found that:

> [W]hen Microsoft receives good news, its stockholders experience average market-adjusted returns of 2.4%. But the news is also good for the industry as a whole, which sees average returns of 1.2% over the same dates. (Both returns are significantly greater than zero at standard levels of statistical significance).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

> During negative events . . . Microsoft stockholders incur average returns of minus 1.2% per event, while the non-Microsoft computer portfolio declines 0.6%.[16]

The returns of a few companies, such as Netscape, which is leading the lobbying and public-relations attack on Microsoft, enjoy increased stock prices whenever the news is bad for Microsoft, which explains why it is instigating the political assault on its rival. It is merely attempting to achieve through politics what it has failed to achieve in the competitive marketplace.

The regulatory persecution of Microsoft is yet another example of regulatory extortion. The political establishment is busy extracting "protection money" from Microsoft in return for its promise to allow the company to exist.

The Tobacco-ization of Industry?

The so-called tobacco industry "settlement" has ominous implications for all industries (and consumers). The model is for a government-funded attack on specific industries, complete with volumes of junk science and taxpayer-funded lobbyists who pressure for advertising bans and other regulations that make it difficult to sell the product, along with higher excise taxes.[17] The industry's management is demonized and portrayed as corporate outlaws. The notion of individual responsibility (for smoking, drinking, reckless driving, firearm use, and so on) is abandoned as "responsibility" is socialized. Once this is done and it is established that no one is responsible for his or her own irresponsible behavior, then it is relatively easy to plunder an industry at will through the vehicle of "taxation by litigation."

Florida, Vermont, and Maryland actually rewrote the laws to strip the tobacco industry of long-standing common law defenses, guaranteeing that those states would win their lawsuits against the industry. There is no reason to believe that politicians will not do the same to other industries now that the precedent has been set. The state governments cleverly hired private trial lawyers to bring the cases and paid them enormous sums—in the tens of millions of dollars *each* in some states.

Tort lawyers are now touting plans to use the tobacco litigation/extortion model against the producers of firearms, lead paint, pharmaceuticals, beer, wine and liquor, chemical additives, fatty foods, sports utility vehicles, biotechnology, and myriad other products. These industries will be demonized, more and more severe regulatory restrictions and excise taxes will be imposed on them, and their stocks will tumble. No industry is safe from the greedy hand of regulatory extortion. □

1. Michael C. Jensen and William H. Meckling, "Can the Corporation Survive?," *Financial Analysts Journal*, Jan.–Feb. 1978, p. 31.
2. Ibid.
3. Ibid.
4. Robert Higgs, *Crisis and Leviathan* (New York: Oxford University Press, 1987).
5. Ibid., pp. 142–43.
6. Phillip K. Howard, *The Death of Common Sense* (New York: Time Warner, 1994), p. 33.
7. Fred McChesney, *Money for Nothing* (Cambridge, Mass.: Harvard University Press, 1997), pp. 29–30.
8. Ibid., p. 57.
9. Ibid.
10. "Requiem for Reform," *Wall Street Journal*, October 14, 1994, p. A–10.
11. Robert Hessen, *In Defense of the Corporation* (Stanford, Calif.: Hoover Institution Press, 1979).
12. John Hechinger, "NACA Helps Low-Income Clients, But its Tough Methods Draw Flak," *Wall Street Journal*, September 13, 1999.
13. Mark Mitchell and Jeffrey Netter, "Triggering the 1987 Stock Market Crash: Antitakeover Provisions in the Proposed House Ways and Means Tax Bill" *Journal of Financial Economics*, vol. 24, 1989, pp. 37–68.
14. Ibid., p. 39.
15. George Bittlingmayer and Thomas Hazlett, "DOS Kapital: Has Antitrust Action Against Microsoft Created Value in the Computer Industry?" *Journal of Financial Economics*, forthcoming.
16. Ibid.
17. See James T. Bennett and Thomas J. DiLorenzo, *Cancer-Scam: Diversion of Federal Cancer Funds to Politics* (New Brunswick, N.J.: Transaction Publishers, 1997).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Economics

The Hidden Cost of Taxation

In my last column I pointed to the harm government typically does when it attempts to promote prosperity by creating jobs. Such attempts always distort the market cooperation that directs people into those jobs in which they create the greatest value. But government does have legitimate, though limited, functions, and performing them requires hiring people. If government confines itself to its legitimate role and performs efficiently, government employees will produce more value than they can in alternative jobs. Unfortunately, government neither limits itself to its legitimate functions, nor performs efficiently. I shall consider one reason for this government failure, a reason based on a distortion in the political process. Because the costs of taxation are never fully considered in political decisions, those decisions are biased in favor of excessive taxing and spending.

The costs of taxation are dispersed widely. Everyone pays taxes, so when a general tax is increased it is spread over so many people that no one individual will find the increase very burdensome. Conversely, if the tax is decreased, no one may perceive a significant benefit. And even if some people do notice the costs of a tax increase, or the benefits of a decrease, an effort to organize other taxpayers (given their large numbers, geographic dispersion, and diverse interests) to take effective political action would be difficult. This helps explain why the costs of taxation are largely ignored politically. Politicians can nudge certain taxes up without hearing from taxpayers, except for some brief grumbling.

Of course, not everyone is politically passive about tax burdens. Relatively small groups with an intense interest in the burden of particular taxes are well positioned to influence policy on those taxes. The federal tax code is full of highly specific loopholes for particular industries, and often for particular companies. Also, some general tax breaks, like interest deductions on mortgages, are seen as promoting a desirable objective (home ownership), are easily noticed as significant by taxpayers, and also benefit an organized interest (homebuilders). Thus they are politically popular.

But the tax loopholes permeating almost all tax systems add to insidious "dead weight" costs of taxation, which result from distorted economic decisions caused by all taxes, but aggravated by tax loopholes. These costs are insidious because besides being widely dispersed, they go undetected even by those who suffer from them. The result is an even greater bias toward excessive taxing and spending.

The Tax Wedge

All taxes drive a wedge between what buyers pay and sellers receive. Consumers pay more than producers receive because of sales taxes, and employers pay more than employees receive because of income taxes. Thus some production and effort worth more than it

Dwight Lee is Ramsey Professor at the Terry College of Business, University of Georgia, and an adjunct fellow at the Center for the Study of American Business at Washington University in St. Louis.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

costs is not provided, and the value sacrificed is the dead-weight cost of taxation. This dead-weight cost is greater when the tax system contains loopholes. When some products or activities are taxed more heavily than others, people will favor those taxed less even when they are less valuable than those more heavily taxed. For example, when much of the cost of a house is deducted from taxable income but not the cost of clothing, people will sacrifice clothing to buy a larger house, even though they value the clothing more than the additional housing space. When the profits in one industry are taxed less than the profits in other industries, people will continue adding to investments in the low-tax industry even though the additional investment would create more value in other industries.

Dead-weight costs of taxation go unnoticed, even by those who pay them, because instead of taking from people what they already have, they take from people what they would have had, but never get. No one sees the extra value that would have been created by economic decisions that would have been made without taxes. The problem here is similar to the one that governments create, and take advantage of, with tax withholding. When taxes are deducted directly from our paychecks, few of us pay much attention to just how much we are paying. Indeed, people often get excited when they overpay their taxes through withholding and get a refund at the end of the year. The tax withdrawals were hardly noticed (and neither is the interest lost because the government had the money), but the refund is obvious and seems to be a gift from the government.

Even though unnoticed, the dead-weight costs of taxation are real and significant. It has been estimated that the dead-weight costs of the federal government's raising an additional dollar equal 39 cents.[1] So for the federal government to obtain an additional dollar, taxpayers have to sacrifice $1.39—$1.00 taken from them directly, plus another 39 cents in value they could have had but never will. But because people are unaware of these dead-weight costs, the political process ignores them, and government decisions that appear efficient actually destroy wealth.

Consider a government program to create jobs that pay $10 million a year in salaries. Assume that the government workers who receive these salaries will create a service worth $12 million a year. This program will be heralded as an economic success, yielding $2 million above its costs (I assume that the only input into the program is labor). But the program is a loser, as is obvious once the dead-weight costs of taxation are recognized. Based on the above dead-weight costs estimate, it will cost approximately $13.9 million dollars to raise $10 million in tax revenue—$10 million in direct tax payments, plus another $3.9 million in value sacrificed because of the economic distortions caused by those tax payments. So instead of being an economic success, the program destroys $1.9 million dollars' worth of value a year.

The Seen and Unseen

All public policies have both seen and unseen effects. Frederic Bastiat, the nineteenth-century French economist, pointed to many of the economic errors people make by focusing on the seen and ignoring the unseen.[2] Although Bastiat did not discuss the unseen dead-weight costs of taxation (he did point out that politicians tend to ignore even the direct costs of taxation), there are few better examples of his general point than taxing and spending. The benefits of government spending are easily seen, and often concentrated on organized-interest groups that exaggerate them to politicians. But the costs of funding the spending, especially the dead-weight costs, are largely unseen. The result is that the political process overemphasizes the benefits of spending, under-emphasizes the costs, and consistently expands spending to economically destructive levels. □

1. See Dale Jorgenson and Kun-Young Yun, "The Excess Burden of Taxation in the United States," *Journal of Accounting, Auditing and Finance*, Fall 1991, pp. 487–508.

2. Frederic Bastiat, "What Is Seen and What Is Not Seen," in *Selected Essays on Political Economy* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1995 [1968]).

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000

Sources of Pro-Union Sentimentality

by Charles W. Baird

I have often wondered why many politicians, journalists, members of the clergy, playwrights, novelists, and far too many others hold labor unions in high regard. From an economist's perspective, they are merely labor cartels that exist mainly to restrict competition in labor markets. Moreover, they have a well-documented history of resorting to violence when they do not get what they want. While they have benefited some workers, they have done so at the expense of other workers and consumers, not capitalists and entrepreneurs.

Yet Congress has seen fit to bestow extraordinary privileges and immunities on labor unions. They are immune to prosecution for committing acts of violence so long as the violence is used in pursuit of "legitimate" union goals. Elimination of competition from nonunion workers is always taken to be a "legitimate" union goal. If a few heads and arms get broken along the way, well, the nonunion workers should have known better. If any other organization commits acts of violence, it is prosecuted. When a union does, it is applauded.

Politicians, of course, may support unions merely because they are a major source of financial and in-kind support in elections; but many politicians, along with others, genuinely think that unions are good for workers and good for the country. Why? There are at least three sources of pro-union sentimentality.

Charles Baird is a professor of economics and the director of the Smith Center for Private Enterprise Studies at California State University at Hayward. He is a quarterly columnist for this magazine.

Muddled Thinking

People are often guilty of woolly, sentimental thinking. For example, Section 6 of the Clayton Act proclaims that unions deserve special privileges because "the labor of a human being is not a commodity or article of commerce." This is unmitigated nonsense. People of course are not commodities or articles of commerce—they are not bought and sold—but labor *is*, no matter what the politicians say. A person's labor consists of the useful services he is able to perform. People offer those services for sale, and other people buy (hire) those services in countless labor markets every day. In fact, when people who seek to sell their labor cannot find willing buyers, the same politicians who deny that labor is a commodity rush to subsidize the disappointed sellers, just as they rush to subsidize disappointed sellers of other commodities, such as corn.

Many people seem to subscribe to the following syllogism: Workers have legitimate rights that ought to be defended; unions exist to defend the rights of workers; therefore, whatever unions do in the name of defending those rights must be legitimate. While the first premise is certainly true, the second is almost always false. Even if it were true, the conclusion is a non sequitur. Actions cannot be justified merely on the basis of good intentions.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Unequal Bargaining Power

Perhaps the most important source of pro-union sentimentality is the widespread belief that individual workers have an inherent bargaining-power disadvantage relative to employers, and that labor unions are the only effective way for workers to overcome that disadvantage. Indeed, the National Labor Relations Act (NLRA) asserts that "The inequality of bargaining power between employees who do not possess full freedom of association or actual liberty of contract, and employers who are organized in the corporate or other forms of ownership association" is one of the principal wrongs the Act is intended to redress. But this inherent bargaining-power disadvantage is little more than a myth.

In any market, whether for labor or dead fish, sellers compete with other sellers to strike deals with buyers, and buyers compete with other buyers to strike deals with sellers. Whether a buyer or a seller, a person's bargaining power depends on the quantity and quality of exchange alternatives he has. In the labor market the buyers are employers and the sellers are workers. In an open labor market, workers compete with other workers to be hired by employers, and employers compete with other employers to hire workers. If a worker has many alternative employment opportunities—if there are many employers eager to hire him—he will have a lot of bargaining power vis-à-vis any one employer. If there is only one employer for whom he could work, he will have little bargaining power vis-à-vis that employer. Similarly, if an employer has many workers who apply for a particular job, he will have a lot of bargaining power vis-à-vis any one worker. If there is only one worker offering to sell labor services to him, he will have very little bargaining power vis-à-vis that worker.

For any given degree of competition among employers to hire, workers will have more bargaining power when there is less competition among workers to be hired. That is what unions are all about. They seek to quash competition among workers to be hired. (They say they want to "take wages out of competition.") They seek to eliminate hiring alternatives employers otherwise would have. They do so by trying to impose standard union wages and trying to exclude nonunion workers from union-impaired markets. A union that succeeds in doing so in any particular market becomes a monopolist in that market.

Likewise, for any given degree of competition among workers, employers will have more bargaining power when there is less hiring competition among employers. If there is no competition among employers—either because there is only one employer in a particular labor market or because the employers in that market have formed a hiring cartel—workers in that market will have almost no bargaining power. Economists call this situation a monopsony (literally, a single buyer).

In the early and mid-nineteenth century there were many labor markets in which employers had monopsony power. The extent of this power gradually waned over the last third of the century, and in the first half of the twentieth century it all but disappeared. Henry Ford did more to increase the bargaining power of workers in general than any labor union has ever done. He did so by mass producing his early automobiles at low prices, which made them available to ever-increasing numbers of people. Automobiles enlarged the area in which more and more workers could search for jobs. Today, technological progress in transportation and communication has eliminated monopsony power in almost all labor markets.

Evidence to support the claim that monopsony power was waning long before labor unions played any significant role has been compiled by Morgan Reynolds at Texas A&M University. Briefly, over the nineteenth century the trend of real wages and workers' material circumstances was strongly positive, worker-initiated job-switching increased steadily and substantially, and large firms (ones likely to have any monopsony power that existed) consistently paid increasingly higher wages than small firms.[1] All this took place without unions. Workers didn't need them then, and workers don't need them now.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Purchasing-Power Fallacy

A third source of pro-union sentimentality is what has come to be called the purchasing-power fallacy. It is alleged that for an economy to have sufficient aggregate demand to sustain full employment, workers must have high purchasing power.

The purchasing-power fallacy confuses real and nominal wages. Lower wages do not mean lower purchasing power if prices are also lower. It also confuses real and nominal aggregate demand. When unions are able to obtain above-market real wages for the employees they represent, real aggregate demand is reduced. Looking beyond the veil of money, within a system of voluntary exchange the production of one good is a source of demand for other goods. People produce wine, for example, in order to be able to exchange it for things other than wine. The production of wine is a source of the demand for things other than wine. The production of wine gives rise to incomes for all the people involved in producing wine. Workers receive wages and salaries; owners of assets receive interest, dividends, and rents; and entrepreneurs receive profits. These incomes come from the difference between the prices consumers pay for wine and the prices the producers have to pay to suppliers of intermediate goods (goods produced by one firm to be used by other firms as inputs, for example, bottles and corks). Receivers of the incomes use them to purchase goods for consumption. Some portion may be spent on wine, but most is spent on other things. Of course, the production of substitutes for wine—beer, for example—directs some demand away from wine. So the source of the demand for any good is primarily the production of *noncompeting* goods.

The only way that a union can successfully obtain above-market real wages for workers is by restricting the supply of labor relative to the demand for it. Restricting the supply of labor in wine production reduces the production of wine. Thus the demand for all the noncompeting goods for which the unproduced wine was destined to be exchanged is diminished. Although the labor that is shut out of wine production will eventually be hired in union-free markets to produce other goods, its productivity will be lower in these alternative employments because it will have been inefficiently allocated. (In open markets, resources, including labor, are allocated to where consumers would have allocated them, which is sometimes called their most highly valued use. The unions' entry restrictions prevent this from happening.)

Similarly, the source of the demand for wine is the production of all the other goods that enable consumers of wine to purchase it. If the production of some of those other goods is also curtailed by union activity, the demand for wine and many other noncompeting goods must decrease. Furthermore, unions usually impose work rules that reduce labor productivity for each quantity of labor hired. From an aggregate perspective, real output is the product of the quantity of labor engaged in production and the average productivity of that labor. Unions reduce both of those factors and therefore reduce the flow of output that is the source of real aggregate demand.

The belief that labor unions have benefited workers in general at the expense of capitalists and entrepreneurs is on a par with the belief that the economic policies of Franklin Roosevelt eliminated the Great Depression. Neither belief can withstand strict scrutiny, but both are widely held. Worse, both lead to unwise public policy. Labor unions are cartels backed by legal compulsion, and until they are stripped of that protection it will be necessary to continue debunking the myths of unionism. □

1. Morgan O. Reynolds, *Economics of Labor* (Cincinnati: South-Western College Publishing, 1995), pp. 12–13.
2. *Legislative History of The Labor Management Relations Act* (Washington, D.C.: National Labor Relations Board, 1948), p. 936.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000

The Day We Read No More

by Angus E. Crane

I recently appeared before the Montgomery County District Court, Traffic Division, in Rockville, Maryland, to challenge a traffic citation. I arrived 30 minutes before the court convened. I must first confess, in the words of Theodore Roosevelt, that "reading with me is a disease." Thus like TR, I always carry a book with me and savor every moment that allows me to read a few chapters or just a snippet. Waiting for the court session to begin, I immersed myself in a Charles Dickens novel. Out of the corner of my eye I spotted a uniformed court security officer towering over me with a black truncheon pointing toward Dickens.

As I glanced up, the officer said, "You're not allowed to read in the courtroom." Mistaking this for a feeble attempt at humor, I chuckled and re-buried my head between the pages. The now ominous nightstick extended itself to the back of my book and flipped it shut. "You're not allowed to read in the courtroom," he repeated.

I was dumbfounded but not too stunned to insist on an explanation. He informed me that reading was prohibited to prevent distractions that might cause a defendant to miss his appearance before the judge. Moreover, the guard elaborated, the rustling of pages creates a disturbance. I pointed out that the court was in recess, so I should be allowed to resume my reading. "You're not allowed to read in the courtroom," he said. My desire to avoid a traffic fine inspired me to hold my tongue.

When the judge entered, he immediately emphasized that we were in *his* courtroom and issued a stern warning that a defendant's name would be called only once. Were a defendant to step outside the courtroom or fail to hear the bailiff's announcement, the case would be rescheduled or a fine imposed. Lastly, the judge confirmed that no reading was allowed.

Three elements of the reading ban disturb me. First, administrative issues are elevated to a higher level of importance than the fundamental right of free choice; this confusion of values evidently stems from the judge's prideful dominion over the courtroom. Second, the judge usurps the individual initiative that forges independent thought and action. Third, the judge's policy ignores the potential ramifications of an encroachment upon the free exchange of ideas, written or spoken.

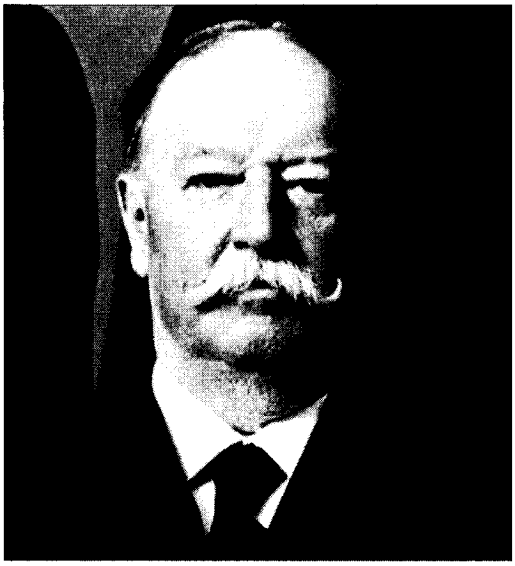
The Presumption of Power

To rationalize a ban on courtroom reading, the judge must have relied on a number of assumptions. Michel de Montaigne once observed that presumption is a vanity that persuades man to establish himself as the equal to God. "Let us smash such presumption," urged Montaigne. The ban on reading suggests that the judge succumbed to presumption's vanity.

The judge's assertive territorial claim on the courtroom left an impression of an authoritar-

Angus Crane is a lawyer in Virginia.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



William Howard Taft (1857–1930)

ian run amok. The courtroom belongs to the people. They pay for it with their taxes, and it has been erected as a community forum in which they seek redress from injury and obtain justice. Certainly the judge's stewardship requires him to administer the law and maintain control over the proceedings. To accomplish that task, the judge is invested with power to preserve an atmosphere of decorum and dignity. Within the reasonable limits of judicial authority, the bench may also prohibit behavior that might degrade the court.

But some judges have taken license to repress criticism of the court. In Florida, for example, the Decorum Rule forbade gestures or expressions of approval or disapproval. The Federal District Court for the Southern District of Florida held that the rule deprived court participants of their First Amendment rights. That decision *(Essen v. Mellon)* follows precedent circumscribing a judge's exercise of his power of contempt and specifically contempt citations in response to personal criticism. In 1925 Chief Justice William Howard Taft cautioned the judiciary that the power of contempt "is a delicate [authority] and care is needed to avoid arbitrary or oppressive conclusions." Taft further exhorted members of the bench to "banish the slightest personal impulse to reprisal." This tradition illustrates the importance of dispelling the mystique of the infallible judge.

Judicial Bullies

Indeed, judicial review boards have deemed some judges bullies. Whimsical rules that infringe on basic rights have been legally invalidated. Judges who have abused their authority have suffered sanctions and in some circumstances have been ejected from office. Simply because a judge is adorned in stately vestments does not bestow the imprimatur of wisdom on the court's actions.

If he focused on his duty to protect the interests of the people instead of flattering himself with his authority, the judge would see that eliminating distractions is secondary to individual rights. The court explained in meticulous detail the consequences faced by a defendant who failed to appear when summoned before the bench. This explicit notice fairly places responsibility on the defendant. Yet by forbidding reading, the judge demonstrates a significant lack of confidence in the defendant's capacity to make the right choice.

The anti-reading policy attacks freedom of choice, the very essence of individuality. In Fyodor Dostoyevsky's *Notes from Underground*, the narrator comments on that essence:

> [M]an may purposely, consciously choose for himself even the harmful and the stupid, even the stupidest thing—just so that he will have the right to wish the stupidest thing, and not be bound by the duty to have only intelligent wishes. For this most stupid thing, this whim of ours, gentlemen, may really be more advantageous to us than anything on earth, especially in certain cases. In fact, it may be the most advantageous of all advantages even when it brings us obvious harm and contradicts the most sensible conclusions of our reason concerning our advantage. Because, at any rate, it preserves for us the most important and most precious thing—our personality, our individuality.

While the judge might suggest that reading could be distracting, he goes further and nursemaids the defendant. The court's attitude of superiority shows a disdain for another's ability to make an intelligent choice. Individuality indeed often produces imprudent

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

decisions, but the repercussions from faulty judgment are insignificant compared to the explosive consequences from an assault on individual freedom.

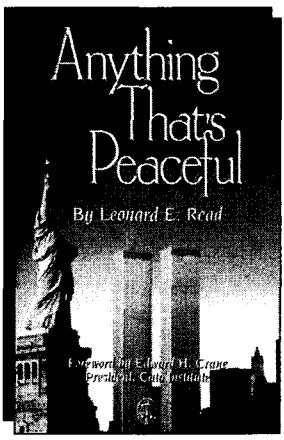
The court's ban on reading hardly guarantees that defendants will pay attention. What if one defendant obediently refrains from reading, but nonetheless daydreams. Another defendant may engage in fantasies so vivid as to render his brain impermeable to the bailiff's voice. Perhaps yet another rehearses an argument with her husband.

The district court also presumed that a defendant could not read and simultaneously listen for the bailiff. There are such gifted people. Granted, many people can do only one thing at a time; they no doubt conduct themselves accordingly.

Dangerous Encroachments

The tyranny of censorship has plagued the written word since the advent of papyrus scrolls. Thus whenever our right to read is tinkered with, an alarm should reverberate across the land. Samuel Johnson accurately described the drive within each human being for knowledge and understanding offered by the written word: "A desire of knowledge is the natural feeling of mankind," Johnson said, "and every human being, whose mind is not debauched, will be willing to give all that he has to get knowledge." Because our ability and opportunity to read the written word are among our most cherished possessions, this fountain of knowledge and learning must never be permitted to evaporate or dissipate.

As a practical approach, all judges and judicial systems throughout the United States should leave reading in courtrooms to personal choice. Where abuse of judicial discretion diminishes individual freedom, the offending judge should be subjected to a professional board of review, with sanctions or expulsion imposed when a judge exhibits a pattern of disregard for personal liberties. □



Anything That's Peaceful

by Leonard E. Read

"Leonard Read said so much, so well, long before any of us began to try to think clearly about it. How much better would life be if laws were simple—if people were allowed to do Anything That's Peaceful*."*
—John Stossel, ABC News

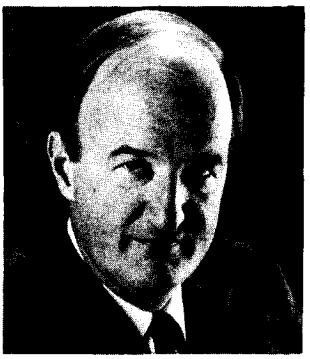
In his inspiring new introduction, Edward Crane, president of the Cato Institute says, *"Anything That's Peaceful* is a classic, compelling statement of the political philosophy of libertarianism." What is that philosophy? At its most succinct, it's this: "Let anyone do anything he pleases, so long as it is peaceful: the role of government, then, is to keep the peace." This is Read in a nutshell. In this work Read analyzes the many harms socialism causes. He discusses the wonders of the free market and he tells his justifiably famous tale, "I, Pencil." As well as any of our books, *Anything That's Peaceful* captures the philosophy of freedom that FEE strives to promote.

242 pages, *paperback* **$6.95**
Plus $4.00 shipping and handling.

Order from The Foundation for Economic Education, 1-800-452-3518

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000



Will the Savings Crisis Lead to Stagnation?

"There is a virtuous cycle in which high growth promotes high saving, and high saving in turn promotes high growth."
—JOSEPH STIGLITZ, Chief Economist, The World Bank

"America's Expansion Cannot Be Sustained."
—*The Economist,* November 6, 1999

In a return to the principles of classical economics, more and more economists agree that thrift is a virtue and should be encouraged. In the textbooks, Harvard's Greg Mankiw promotes the new view toward saving: "Higher saving leads to faster growth."[1] Contrast Mankiw with the anti-saving mentality held by Paul Samuelson and other old Keynesians, who argued that higher saving may result in a recession or worse ("the paradox of thrift").

A newly released study by the World Bank reinforces this new positive outlook for saving.[2] Under the guidance of chief economist Joseph Stiglitz, the bank came to the following startling conclusions regarding world saving:

Saving and interest rates: "The world saving rate has been declining and the world real interest rate has been increasing since the 1970s" (p. 7). Of course, saving rates vary dramatically among countries. For example, they have doubled in East Asia, stagnated in Latin America, and collapsed in sub-Saharan Africa.

Saving and income: "Long-term saving rates and income levels are positively correlated across countries" (p. 12). In other words, saving rates tend to rise with per-capita income. As people become wealthier they tend to save more. But only up to a point. The World Bank notes that saving ratios appear to level off at high levels of income.

Saving and economic growth: "Higher-saving regions have also enjoyed faster income growth." Countries that save more also grow more, although the evidence is not clear which comes first, faster growth or higher saving. In any case, they go hand in hand. Stiglitz concludes, "high saving is associated with good macroeconomic performance and sustainable access to foreign lending" (p. ix).

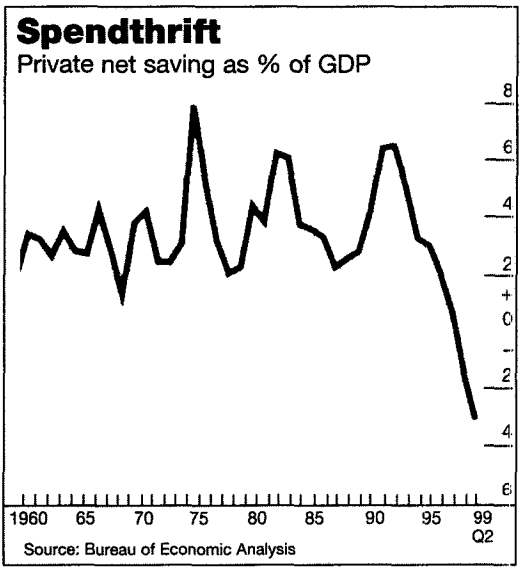
Saving and foreign aid: "Most [economists] conclude that aid crowds out national saving" (pp. 17–18). Given that the World Bank's purpose is to dole out foreign aid, this frank admission is amazing.

Mark Skousen (http://www.mskousen.com; mskousen@aol.com) is an economist at Rollins College, Department of Economics, Winter Park, FL 32789, a Forbes *columnist, and editor of* Forecasts & Strategies. *His textbook,* Economic Logic, *is now available from FEE.*

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

U.S. Living on Borrowed Time

Given this positive relationship between saving and economic performance, what are we to make of the sharp decline in private net saving in the United States? The latest data indicates that private net saving—the gap between disposable income and spending—has fallen to a record low of negative 5.5 percent of GDP in 1999. (See the graph below.)



Of course, millions of Americans continue to save for retirement, investment, and other reasons, but lately the debtors have outnumbered the savers. The tenuous government surplus has only partly offset the private-sector dissaving. Who makes up for the imbalance? Foreign investors (as reflected in the growing current-account deficit) are pouring billions into U. S. debt and equity securities, bank accounts, and real estate.

A recent study by two British economists, Wynne Godley and Bill Martin, warns that the United States is headed for serious trouble. They point to three unsustainable imbalances: an overvalued stock market, the collapse in private saving, and an alarming increase in debt.[3]

Other countries facing these imbalances—Japan, Britain, and Sweden in the late 1980s—experienced sharp slumps after asset-price bubbles burst.

What has caused the sharp drop in U.S. private net saving? Many economists blame the booming stock market, encouraging households to spend more and firms to invest more. I would add two other factors: the Bush-Clinton increases in the marginal tax rate (higher tax rates reduced disposable income, forcing households to save less) and the Federal Reserve's liberal monetary policy since the 1997 Asian financial crisis (monetary inflation has fueled the bull market on Wall Street).

Throughout the 1980s and 1990s I was bullish on the U.S. stock market. Supply-side economics and globalization kept inflation under control and the economy out of recession. Now, as we enter a new century, most trends are still positive, but we must not ignore the signs of inflation. If Ludwig von Mises and F. A. Hayek taught us anything, it is that artificial prosperity fueled by debt and monetary inflation cannot last forever. The bust is inevitable, although its severity can be offset by tax cuts, privatization of Social Security and Medicare, and expanded savings. □

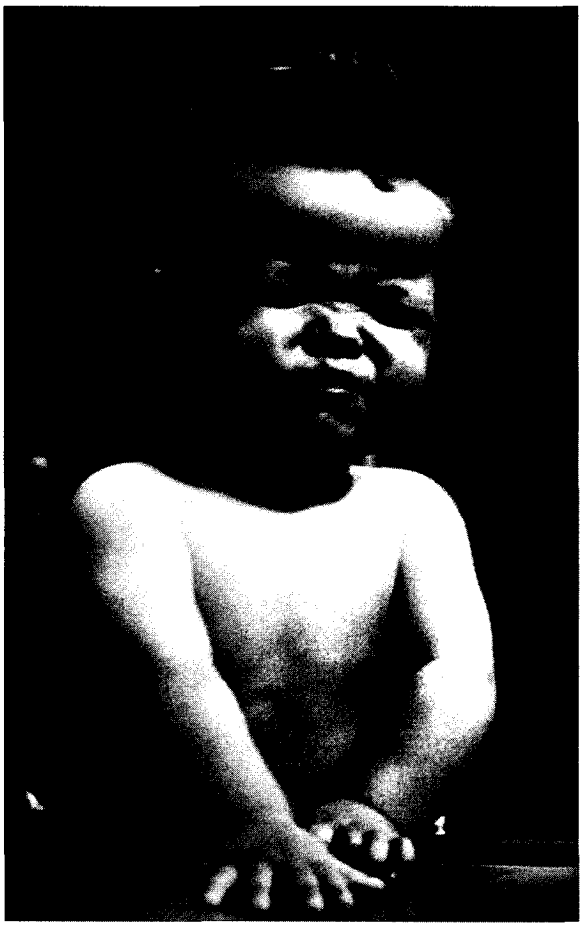
1. N. Greg Mankiw, *Macroeconomics*, 2nd ed. (New York: Worth Publishers, 1994), p. 86.

2. All citations are taken from Klaus Schmidt-Hebbel and Luis Servén, eds., *The Economics of Saving and Growth* (New York: Cambridge University Press, 1999).

3. "Living on Borrowed Time," *The Economist*, November 6, 1999.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Have you heard the latest from Washington?



These days it seems as if everybody is crying for the truth. But how often do you actually feel that you can believe what you hear or read?

If puréed truth and strained journalism makes you want to scream, we'd like to invite you to subscribe to *The Washington Times National Weekly Edition*, the only nationally circulated newspaper in the country with the courage and conviction to cover the news honestly.

Every week, we'll bring you a fresh, honest, unbiased look at the people and events that shape the news in Washington D.C. and around the world. No liberal spin. No hidden agenda. Just vigorous, unapologetic journalism and clean, crisp writing.

Anything less would be downright childish.

Try It FREE!

Call today and order 4 weeks of *The Washington Times National Edition* free of charge! If you like it, you'll receive 48 more issues, for a total of 52 and pay only $59.95. If you decide not to subscribe, simply write "cancel" on your invoice and owe nothing at all! The 4 sample copies will be yours to keep!

Name _____

Address _____

City _____

State _____ Zip _____

Credit Card # _____ Exp. Date _____

Signature _____ Phone _____

Make checks payable to: *The Washington Times NWE.* Clip and mail with payment to: PO Box 96601, Washington, DC 20090

For lightning-fast delivery, call 1-800-363-9118 (Mention express code: 2055)

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

CAPITAL LETTERS

Why Y2K?

To the Editor:

"Bill O. Reitz" overcomplicates the Y2K situation ("Why Y2K?," December 1999). I spent over 20 years in the information-processing business from the late '60s until the early '90s, so I have some knowledge of the genesis and continuation of the so-called Y2K problem. I worked with "magnetic drum" and "core" as well as punched cards, sorting and collating machines, and all the other paraphernalia of the early days. I have no real problem with either of Mr. Reitz's descriptions of how two digits were used to save space. I can remember programming subroutines in "machine language" to save a few bits (not bytes) of precious room. So I'm just as guilty as anyone, if indeed guilt is the appropriate term.

I start to lose patience when people say that Y2K came as a surprise to the industry and that programmers and analysts are at fault for not correcting the problem before it became critical. When I first went to computer school in the '60s it was made clear that the two-digit date was a matter of expediency and would cause problems sooner or later without attention. Anyone in data processing who had a two-digit IQ knew it was a time bomb.

As far back as the late '70s and early '80s I recall sitting in design and development meetings where the technical people strongly urged that the date fields be expanded because it was becoming apparent that software had a much longer life span than had been thought. In every case it was the managers/bureaucrats/executives at the urging of the "bean counters" who decided that such a change was a budget- and schedule-buster, and they weren't about to spend the resources. So in fact Y2K came to be in spite of technical protests, and programmers and/or analysts are not to blame.

It's also my opinion that the job mobility of people in data processing at the time contributed to the problem because the responsible (or irresponsible) managers/bureaucrats/executives could be fairly certain that they would no longer be employed at the same place when the "%&#@ hit the fan" (euphemism for Y2K).

The upshot is that the Y2K problem is the result of bad business decisions, not technical "stupidity and incompetence."

—CHARLES STONE
Kissimmee, Florida

Bill O. Reitz replies:

The point of my article was why Y2K came to be in the first place, more than why it was perpetuated. As for overcomplication, as I said, I don't know if such an analysis (as I included in the article) was done or not; but that if one was done, the programmers (and managers) made what they would have concluded to be the correct decision based on the available information.

I don't think that Y2K was a surprise to anyone in the know. Even the original programmers no doubt knew of the problem and that someday things would need to be done differently. Mr. Stone implies an interesting point, which I had not considered—that the reason the Y2K "bug" was perpetuated was that software was written incrementally, that is, each new version was derived by modifying the previous version. Given this approach, it is easier to understand why the managers might have acted as Mr. Stone says. This would support Mark Skousen's idea, which is that people who should have known better took a short-sighted approach for short-term gain. Even then, though, it is possible that the managers simply chose to defer this expense to the future. Unless there is a particular advantage to fixing a problem right away, it

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

might be a reasonable decision to defer the fix. In other words, if the problem had already gotten large enough, there was not necessarily any advantage to fixing it right away.

I don't think that anyone will ever be able to say with certainty when, or if, things should have been done differently. The point of my article was to get people to think about how the situation came about in the first place. It appears to have done so.

The New Puritans?

To the Editor:

When I read Sheldon Richman's "Other People's Business" (December) I couldn't help but think of H. L. Mencken's definition of Puritanism as "the haunting fear that someone, somewhere may be happy." If Galbraith & Co. would mind their own business and live in the world of reality (versus the fantasy world of pure theory), they would be less likely to invent new ways of ordering our lives.

Besides, isn't Galbraith's credibility deficient? Does he really expect to be taken seriously after he has been wrong so often? Lest it be forgotten, Galbraith glorified socialism and the Soviet economy for decades. Completely out of touch with reality, he was taken by surprise when that tyranny collapsed.

Of course, many who had "less prestige" and were "less learned" than Galbraith predicted the failure of socialism decades in advance (Mises, Hayek, Friedman, Reagan, and others). Galbraith was still pointing to the integrity and stability of the Soviet economy as a shining example to follow even as East Berliners flocked westward.

As far as I'm concerned, John Kenneth Galbraith and those of similar persuasion have no credibility remaining. I have no doubt that Galbraith's ideas continue to hold sway over those that refuse to recognize the failure of their long-cherished beliefs. But those of us with less personal investment in such beliefs are under no such compunction to "keep the faith."

—MICHAEL KOLLER
Germantown, Maryland

Inspired? Shocked? Delighted? Alarmed?

Let us know.

We will print the most interesting and provocative letters we receive regarding articles in *Ideas on Liberty* and the issues they raise. Brevity is encouraged; longer letters may be edited because of space limitations. Address your letters to: *Ideas on Liberty*, FEE, 30 S. Broadway, Irvington-on-Hudson, New York 10533; e-mail: iol@fee.org; fax 914-591-8910.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

BOOKS

Financing College Tuition: Government Policies and Educational Priorities

edited by Marvin H. Kosters

American Enterprise Institute • 1999 • 129 pages • $29.95 cloth; $14.95 paperback

Reviewed by George C. Leef

Higher education is a prodigious sacred cow in America. Consisting overwhelmingly of institutions that do not have to pass the test of the market and that subsist largely on funds that come directly or indirectly from government, our higher education system grows, absorbs resources, but educates less and less. Good public-relations work and an image that derives from bygone generations shields the system from scrutiny except by a small number of observers. With many well-placed political allies, higher ed grows fat and happy.

The literature on higher ed falls into three categories. In the first, the "cheerleader" category, are works that sing its praises, complaining only that it does not receive enough money; in the second are works that find some fault with the course of higher ed, but do not question the underlying assumption that government support and regulation are necessary; finally, there is a small literature from radical critics who see government as poisoning the system.

Financing College Tuition, disappointingly, falls into the second category. I had hoped for a radical critique. Instead I found a timid collection of essays that contain some excellent observations and arguments but don't penetrate to the heart of the problem.

Editor Marvin Kosters, a resident scholar at the American Enterprise Institute, contributes an introduction that sets the tone by reiterating a favorite assumption of the educationist: "The rising educational level of the work force has contributed importantly to the growth of productivity and real incomes in the United States." Once you make that assumption, it is unlikely that you will seriously question government higher-education policy, since our very prosperity seems to hinge on keeping up the flow of college graduates.

One can be in favor of higher education but doubt the extravagant claims that are made for it. The growth rate of the U.S. economy was robust throughout the nineteenth century, when relatively few people pursued college degrees (and those who did rarely did so because they thought it enhanced their productivity), and has slowed in the last third of the twentieth, when college enrollments have skyrocketed. Maybe it's not the case that having more college graduates causes greater prosperity. Maybe it's the case that greater prosperity enables more people to afford to pursue college degrees.

Putting that point aside, the book contains essays by Eric Hanushek, Caroline Minter Hoxby, Thomas Kane, and Stephen Cameron and James Heckman. All are well-known scholars who have written extensively on educational issues and whom one might label "conservative."

Hanushek, for example, is famous for his assault on the notion that higher spending leads to better results in K–12 education. His essay, "Budgets, Priorities, and the Investment in Human Capital," seeks to spell out what he thinks the government's role in higher education should be. He sees the root of our educational malaise in our dismal K–12 system and ponders why we should devote considerable resources to higher education, largely subsidizing the education of students who are apt to be successful anyway, while neglecting the many whose educations are woeful. Hanushek's explanation is that government higher education policy is just another politically motivated device for transferring wealth to a strong interest group—parents of college students. Exactly.

Alas, he concludes that the federal government "has some strong and obvious roles" in higher education. Like what? He suggests that it should provide "leadership in policy development." Sorry, but we no more need "policy leadership" from government in higher education than in the computer industry, auto industry, or anywhere else.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

Caroline Minter Hoxby's essay, "Where Should Federal Education Initiatives Be Directed?," scores a knockout against President Clinton's proposals for expanding "access" to higher education, which means luring more marginal students into the system with government subsidies. She concludes that little good will come of it, at considerable cost, including the further degradation of standards.

The essays by Kane and Cameron and Heckman likewise are useful in helping to fend off proposed educational follies. Kane exposes the undesirable consequences of new college financing gimmicks like the $1,500 tax credit for tuition expenses. Cameron and Heckman weigh in against the idea that the nation should combat rising "wage inequality" by throwing billions more into higher ed.

Not bad, but why couldn't a shortish book ostensibly on the financing of college have included at least one essay by someone from that third camp, questioning the wisdom of taxpayer financing through grants, loans, and subsidized tuition? Economist Alan Reynolds, for instance, has written, "the most equitable and efficient method of finance is not taxpayer subsidies to either students or institutions, but intelligent use of capital markets."

Now there's a radical idea worth exploring. □

George Leef is director of the Pope Center for Higher Education Policy at the John Locke Foundation and book review editor of Ideas on Liberty.

The Right to Home School: A Guide to the Law on Parents' Rights in Education

by Christopher J. Klicka

Home School Legal Defense Association • 1998 • 198 pages • $10.00 paperback

Reviewed by Karen Y. Palasek

While the title would suggest otherwise, Christopher Klicka's book is not the kind of text most homeschool parents would pick up and read. In practice, homeschool parents tend to focus on how-to books and curriculum reviews, with a smattering of methodology thrown in for good measure. Homeschool bulletin boards, discussion lists, and my own support-group meetings reflect those concerns. With the exception of start-up requirements, the law as it applies to homeschooling is virtually never discussed. So why bother with a book on homeschool case law?

All homeschool parents, especially those who have made a long-term commitment to homeschooling, should read this book. *The Right to Home School* is full of information about actual cases and studies involving homeschool families, and is so well researched and documented that the citations alone are worth the reader's time.

Klicka is senior counsel of the Home School Legal Defense Association (HSLDA), and the cases in his book describe much of his own work. As long as legal challenges continue, future court decisions will make the status of homeschooling evolutionary and uncertain. Klicka's book is really a chronicle of those challenges and resulting court decisions; the ability to exercise the fundamental right of educational choice in every state is either upheld or eroded with each successive case.

The author first discusses why parents choose to homeschool: to incorporate religion into school life, to exercise choice in topics and values in secular education, or to provide their children with a private alternative to government-run classrooms. Many homeschools operate for a combination of reasons. We come to understand the rights, challenges, and defenses that parents encounter in each situation.

A big issue facing parents in each state has been the question of who has the authority to make educational decisions about children. Klicka examines that problem by presenting numerous cases handled by the HSLDA. Often they involve homeschool families embroiled in truancy and other disputes in their districts. Homeschool parents can gain a useful understanding of cases in which the law has been scrupulously applied, as well as those in which it has not. The resulting decisions in the federal and state courts define the legal standing of homeschooling today. Even favorable decisions, however, have not elimi-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

nated the struggle faced by many parents to *exercise* their existing legal rights.

Homeschooling is growing at a rate of 15 to 40 percent per year in the United States, with 700,000 to 1,200,000 children in grades K–12. Confounding the predictions of the government education establishment that homeschooled children would be intellectually handicapped by not receiving schooling from "the experts," statistics now confirm the superior results of homeschooling compared to public school and even to private schools. Homeschool regulations are different in every state and range from minimal to almost insurmountable. Discriminatory and unreasonable standards have often been imposed as the education establishment tries to keep its grip on American children. Despite those obstacles, and with the assistance of the HSLDA, more and more parents are exercising their rights to direct the education of their children, tailoring the pace and curriculum to the needs and interests of the child and thereby maximizing the likelihood of success.

Part of the mission of HSLDA is to arm homeschool parents with knowledge about legally defensible homeschool arrangements. Through an in-depth look at the experiences of homeschoolers in the courts, readers of this book will become better educated about their rights. Any new or current home educator should find it enlightening, although reading about the battles people have had to fight just to secure the right to educate their children at home is sure to raise your blood pressure.

For me this book was an unexpected find, and thoroughly welcome. □

Karen Palasek is an adjunct professor of economics at Campbell University, Buies Creek, North Carolina.

***The Fountainhead:* An American Novel**
by Douglas J. Den Uyl
Twayne Publishers • 1999 • 123 pages • $32.00

Reviewed by Tibor R. Machan

"But of course, if individualism really is central to Americanism, then *The Fountainhead* is the quintessential American novel." This is the concluding sentence of Douglas Den Uyl's wonderful discussion of Ayn Rand's great novel, which has been at the center of the resurgence of interest in the philosophy of individual freedom. Den Uyl shows that Rand's book is not only inspiring, as art ought to be, and philosophically meaty, as many classic novels surely are, but also that it is a literary masterpiece.

The tone of Den Uyl's book is important. It is one of understated respect and admiration for Rand's accomplishment, one of thoughtful analysis rather than fawning praise. Sadly, we have come to expect works on Rand, including the recent movie, *A Sense of Life*, to be either uncritical pleading on her behalf, with little attention to any possible problems in her philosophy, or angry denunciation, giving her credit for nothing at all, let alone acknowledging any literary merit in her novels. Den Uyl's gentle but exacting discussion is a relief from such Rand-partisanship and Rand-bashing.

Den Uyl argues convincingly that in *The Fountainhead* Rand's literary achievement is extraordinary and often superior to other authors who enjoy such a reputation with the experts. This is not surprising, given that many intelligent and artistically sensitive people have found it easy to embrace Rand as a great artist, not merely a writer with powerful philosophical ideas.

What I found most rewarding is how Den Uyl accomplishes the task of convincing the reader of Rand's artistry, using example after example to show how well crafted a novel *The Fountainhead* truly is. For instance, he shows the remarkable complexity of the book's characters with numerous passages and conversations. Consider this excerpt from one of Ellsworth Toohey's conversations with Dominique Francon:

> "I wonder what you are essentially. I don't know."
>
> "I dare say, nobody does," he said pleasantly. "Although really, there's no mystery about it at all. It's very simple. All things are simple when you reduce them to fundamentals. You'd be surprised if you know how few fundamentals there are. Only two,

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

perhaps. To explain all of us. It's the untangling, the reducing that's difficult. That's why people don't like to bother. I don't think they'd like the results either."

"I don't mind. I know what I am. Go ahead and say it. I'm just a bitch."

"Don't fool yourself, my dear. You are much worse than a bitch. You're a saint. Which shows why saints are dangerous and undesirable."

Den Uyl then comments: "The point here is not that Dominique does not know what she wants or that she is unclear about her values. She is a compelling mixture of decisiveness and certainty on the one hand and the unconceptualized on the other, as further evidenced in the following passage: 'Roark, I can accept anything, except what seems to be the easiest for most people: the halfway, the almost, the just-about, the in-between. I know that is one thing not given to me to understand.' "

A great many more such line-by-line discussions fill this little book. The reader is apt to wish for much more.

This book is a bit like a mystery because not until the end does Den Uyl fully reveal his own view of Rand's novel. Let me just hint that it revolves around Dominique.

I recommend this book not only to those who have found Rand's work inspiring and philosophically, ethically, politically, and economically fruitful, but even more so to those who have found Rand's literary skills lacking or simply accepted the judgment of detractors who speak with confidence but have scarcely read her fiction.

To thousands of champions of individualism, Ayn Rand has been a seminal figure. Den Uyl's book teaches them—and anyone else willing to listen—how to fully appreciate *The Fountainhead* and to see why it is perhaps *the* American novel of the twentieth century. □

Tibor Machan is a professor in the school of business and economics at Chapman University.

Alternate Route: Toward Efficient Urban Transportation

by Clifford Winston and Chad Shirley

Brookings Institution • 1998 • 120 pages • $36.95 cloth; $15.95 paperback

Reviewed by John Semmens

Urban transportation in America suffers from gross inefficiencies. The source of these inefficiencies is political intervention that pushes transportation policy away from cost-effective solutions and toward the distribution of benefits to favored groups—predominately transit managers and suppliers of transit inputs (that is, labor unions, manufacturers of transit equipment, and builders of transit facilities).

The authors estimate that, as currently operated, the costs of public transit exceed the benefits by $6 billion per year. The net negative results are evidenced by mostly empty buses and trains. The authors report that on average only 14 percent of bus seats and 18 percent of train seats are filled.

In contrast to the net loss from transit, highways appear to be contributing large net benefits. The authors estimate that on an annual basis, the benefits from urban highways exceed costs by more than $200 billion.

The authors' recommendations for improving urban transportation efficiency are directly at odds with current government policy. Both federal and local governments have been steadily increasing subsidies to public transit in order to increase bus frequencies and in many cases to build new rail lines. The authors point out that 30 years of increasing subsidies have failed to lure urban travelers out of their cars. There is little to indicate that maintaining or increasing these subsidies will be any more successful in the future.

Instead of continuing the failed current policy of massive subsidies, the authors advocate privatization. As it now stands, public transit policy is more oriented toward division of "loot" than the efficient production of transportation service. Since customers supply only a small fraction of the total revenue, attention to customer needs is not a high pri-

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

ority. Under privatization, the incentives for transit operators would be shifted toward a more customer-friendly focus because revenues would depend directly on pleasing customers.

Instead of running largely empty buses up and down major streets, a privatized transit system would be drawn toward using smaller vehicles catering to the relatively short typical transit trip (which averages less than five miles). A model for the privatized transit of the future exists today in the "Queens Van Plan." This is a privately operated transit service in New York City that serves mostly low-income neighborhoods. Despite an unsubsidized fare of only $1, the service operates at a profit. The owner would like to expand beyond the borough of Queens, but is presently barred from doing so by the city council. You see, the public transit system needs to hold on to a "captive" transit clientele lest their case for large extractions from taxpayers be undermined.

The authors also make short shrift of the argument that privatization would harm the low-income transit users who depend on current transit service. They write that the average income of bus commuters is $40,000 and that of rail commuters is $50,000. Further, they claim that transit routes serving minorities are typically less well funded than those that serve more influential political constituencies. The authors favor vouchers for low-income people over the current system.

The authors also advocate privatization and congestion pricing for highways. The already substantial benefits of urban highways could be improved by moving roads out of the socialist, government-owned-and-operated mode and into the commercial mode. Commercially oriented road operators would adapt strategies similar to those used by the phone company to better manage existing capacity and reduce the dead-weight loss of traffic congestion. Peak period road users would pay more. Off-peak users would pay less. The aggregate value of time saved by reducing traffic congestion would result in net benefits for society.

The book is brutally honest in its analysis of current transit performance and daring in its prescriptions for reform. The fact that it is published by the Brookings Institution, an ultra-mainstream think tank, should catch the attention of those prone to dismiss criticism of public transit as right-wing propaganda. It merits the thoughtful consideration of anyone interested in improving urban transportation. □

John Semmens is an economist with the Laissez-Faire Institute in Chandler, Arizona.

Guilt, Blame, and Politics

by Allan Levite

Stanyan Press • 1998 • 259 pages • $16.95 paperback

Reviewed by James A. Woehlke

Allan Levite adds an important perspective to the political landscape. He builds an overwhelming case that a certain social profile, the "Guilt Profile," breeds leftist radicalism. He discerns a pattern: a disproportionate number of statist ideologues hale from well-to-do or wealthy backgrounds or have occupations that are far removed from the workaday world. Levite argues that they suffer from a form of guilt—political guilt—that derives not from their individual sins but rather from their "privileged" status.

"This pattern," he writes, "is so prevalent that by adding to it the Guilt Profile's theoretical base, we [can] dispense with the old notion that these individuals became radicals 'in spite of' their elevated socio-economic status, and begin to assume that they became radicals *because* of it."

Levite solves two puzzles that have confused conservatives and libertarians about radicals on the political left. The first is about what really motivates them. Conservatives and libertarians assume that "liberals" and socialists are motivated by a quest for power. Levite contends that it is instead often a desire to erase the distinction between themselves and "the workers." As liberals assume the patina of workers, they lose their guilt. But a dilemma remains for them, because they want to become part of the working class while maintaining the benefits accruing to intellectuals.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

This dilemma leads to the second puzzle for conservatives and libertarians. It is so blazingly obvious today that a free-enterprise system improves the lot of the poor, paving a superhighway out of poverty for many. It is equally clear that redistribution leads to stagnation and decline. Why does this so thoroughly elude the left? Why do liberals prefer redistribution to additional production of wealth as a solution to poverty?

Levite's answer begins with the realization that leftward-leaning intellectuals like their lot in life. They love the soft jobs they hold as professors, journalists, and entertainers; and they want to keep those jobs. Still they suffer a nagging, if misplaced, guilt that to remain in those soft jobs, others must toil in tedious or backbreaking occupations.

To atone to those poor workers and assuage their own feelings of guilt, leftists support the state as an institution of redistribution, not so much to relieve them or others of their wealth, but to be an independent, outside force that blesses their lives and livelihoods. The state in effect says, "It's all right. You may be a journalist or an academic, but you're part of the working class now, and you're earning just what you should in support of your brother and sister proletarians."

Levite cites the comment of French novelist Simone de Beauvoir, "I know that I am a profiteer, and am one primarily because of the education I received and the possibilities it opened up for me. I exploit no one directly; but the people who buy my books are all beneficiaries of an economy founded on exploitation. I am an accomplice of the privileged classes and compromised by this connection." Levite concludes that "de Beauvoir did not want to command or rule, but to *be* commanded and ruled—to live in a 'planned' society that would have specific rules and procedures to decide *for* her how much income she could have, where she could live . . . and so on. If such rules have been established, one need only obey the rules to be relieved of responsibility, thereby alleviating the discomfort produced by political guilt." The guilt-ridden leftist intellectual looks to the state to establish those rules, which make the lives of millions miserable, but make him feel better.

Levite writes persuasively, but the book comes across as overly documented. Portions of it—those consisting of page after page of identifying individual radicals and tracing their origins—would have been better banished to an appendix. His research is valuable, providing a useful compendium of prominent leftists afflicted with political guilt. The problem is in the presentation.

The political guilt Levite describes is unwholesome and socially destructive. It undoubtedly serves as a drag on the freedom and prosperity of all the rest of us who don't feel that our wealth and success are unmerited and exploitative. It is an arresting thought that the damage wrought by burgeoning statism may be rooted more in the psychological frailties of leftist intellectuals than in a conviction that it works. □

James Woehlke is the counsel and director, Technical Services Division of the New York State Society of Certified Public Accountants.

The Third Way:
The Renewal of Social Democracy

by Anthony Giddens

The Polity Press • 1999 • 166 pages
• $19.95 paperback

Reviewed by Antony Flew

The importance of this book lies in the fact that its author is often and with good reason described as the guru of British Prime Minister Tony Blair. It tells us much about the thinking of politicians of his kind.

The social democratic parties of the European mainland were all originally Marxist, committed to socialism in the sense of public ownership and control of the means of production, distribution, and exchange. By the 1930s, however, the ruling Social Democratic Party in Sweden had abandoned socialism in favor of a third, or "middle," way between capitalism and the full-blown socialism of the USSR. The British Labor Party had never been a truly Marxist party (despite some Marxist elements), but clung to many categorically socialist aims. After four successive

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

defeats at the hands of the Conservatives, in the early 1990s Blair, as its leader, was able to get Labor to abandon its official embrace of socialism. But its intellectual leaders, like Giddens, remain wedded to the interventionist state and the need to produce a replacement "third way" between free and totalitarian societies.

Giddens attempts to distinguish his "third way" objectives from the goals attributed to unidentified "neo-liberals," "new rightists," and "market fundamentalists." One signal difficulty is that his own objectives are frequently inconsistent. For instance, he writes, "The democratization of democracy first of all implies decentralization, but not as a one-way process." Somehow, he thinks that decentralization may be furthered by moving in opposite directions at the same time. The egalitarian in Giddens wins out over the democrat since he regards it as a decisive objection against a policy of greater self-government that "Some cities or regions could thereby forge ahead of others, worsening the marked regional inequalities that already exist in the U.K." Having paid homage to the leftist deity of equality, he goes on to say that social democrats "should move away from what has been in the past an obsession with inequality, as well as to rethink what equality is. Equality must contribute to diversity, not stand in its way." What's it to be? At least one knew where the old Labor Party stood.

When Giddens's objectives are consistent, he still does not tell us how, on social democratic principles, they might be achieved. Thus he recognizes that "welfare benefits can create perverse consequences that undermine what they were designed to achieve," and allows that it is "surely correct to worry about the number of people who live off state benefits." Yet he continues to insist that welfare expenditures "should remain at European rather than U.S. levels" without so much as mentioning Charles Murray's Law of Unintended Rewards, much less suggesting any possible means of preventing its consequent operation. The author does mention the unprecedented growth in the numbers of single mothers, but refrains from noting that this must have been due at least in part to the availability of hopefully unintended rewards from the state.

The adverb "hopefully" has to be inserted above since he writes that "Sustaining continuity in family life, especially protecting the well-being of children, is one of the most important goals of family policy." Yet Giddens immediately insists that "This can't be achieved, however, through a reactionary stance," such as trying to reinstate "the traditional family." He pointedly encloses that phrase in smear quotes. What he says he means by that expression is an institution "based on the inequality of the sexes and the legal ownership of wives by husbands." This is of course a straw man, and Giddens admits on the very next page that "when rightist critics speak of the traditional family, they don't mean the traditional family at all." Yet this recognition does not lead him to withdraw his irrelevant dismissal of their actual criticism of the consequences of state welfare.

The book proves no less confounding when the author turns to international matters. Giddens asserts that "in the context of the European Union, the nation state is not disappearing." It would be difficult to say anything more misleading. Certainly the number of nation states has recently increased due to the collapse of the Soviet and Yugoslav empires. But the ultimate intention and purpose of the European Union has always been the creation of a centralized superstate, a United States of Europe, embracing all those previously independent states that eventually become its members.

Giddens's "third way" turns out to be no better than any of the many previous works purporting to show that state intervention can improve upon a free society. It is riddled with inconsistencies and demonstrates again that socialists, whether moderate or extreme, learn nothing from their own mistakes or from the criticisms of their program made by advocates of liberty. □

Antony Flew is Emeritus Professor of Philosophy, University of Reading, England.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

IDEAS ON LIBERTY
MARCH 2000

They Can Afford It, Can't They?

A lot of bad public policy is based on the "they can afford it" principle. Pharmaceutical prices should be lower because pharmaceutical companies can afford it. Health insurance should cover two days in the hospital for mothers and their newborns because health insurance companies can afford it. My favorite example of recent months is the furor over ATM fees.

Once upon a time there was a world without ATM machines. You had to actually go to your bank, a giant assemblage of bricks and mortar to get your money. Imagine someone saying he would put a branch of the bank very near your house, a little tiny branch called an ATM. And miraculously, for a surcharge of maybe an additional two dollars you could even use the ATM of a bank that was not your own.

It would probably seem like an incredible bargain. Alas, what once was a bargain is now considered an outrage by some. Some people think banks should not be allowed to charge noncustomers a direct fee for using their ATM machines. These fees should be eliminated, so the argument goes, because the customers' own banks already pay the ATM's bank a fee. And after all, banks make enough money already—they can afford it.

Market-based solutions to social problems often fail politically because of the way an issue gets framed in the media and the policy arena. In the debate over whether companies can afford to be regulated, market-based solutions almost always lose. After all, the companies *can* afford it in the popular sense of the term. They are always profitable, at least when the regulations are proposed.

Is there a good argument against the "they can afford it" gambit?

Shortly after the Santa Monica, California, city council and the voters of San Francisco voted to ban ATM surcharges in their respective cities, I heard a radio news story discussing the issue. The story quoted a Bank of America spokesman and a man in the street. The spokesman for Bank of America said, "Grocers don't give away groceries. Doctors don't give away medical care." He sounded exasperated. He was probably being quoted at the end of a long and abusive interview.

Giving Things Away

On the surface, the spokesman's argument was silly; banks and other businesses give away lots of services for free while charging for others. Giving him the benefit of the doubt, I think he meant to say that banks, like every other business in America, should have the right to charge for their services.

I agree. Maybe even the courts will recognize that cities have no right to regulate banking fees. (I despair of the courts' ruling that the federal government has no such right either.) But in the battle for public opinion, rights-based arguments (and especially con-

Russell Roberts (roberts@csab.wustl.edu) is the John M. Olin Visiting Professor of Labor Economics and Public Policy at the Center for the Study of American Business at Washington University in St. Louis.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

stitutional arguments) are often unpersuasive. Much more common is the argument of the man on the street whose quote followed the Bank of America spokesman's. It went something like this: "Banks make a lot of money. What right do they have to charge $1.50 for me to get my own money?"

The banks and the pharmaceutical companies and the health insurers need to reframe the argument if they want to have any impact on public opinion.

It helps to think of the ATM as a very specialized vending machine. When we go to a soda vending machine, we understand there are two costs of using the machine: the soda itself and the storage and refrigeration costs. In the case of a soda vending machine, these costs are combined into a single fee you are charged to get a soda.

In the case of the ATM, there are implicit and explicit fees to cover the various costs of storing and providing the money: the cost of maintaining the machine, the cost of keeping it filled with cash, and the occasional loss of cash due to theft. When you get money from a machine belonging to a bank that is not your own, there are additional costs and additional fees charged to your account.

But suppose there were no fees taken from your account. Suppose if you wanted to use the machine of a bank that was not your own, it took six quarters to use the machine. Imagine standing in front of the machine, about to put your six quarters in, when along comes an affluent well-dressed man in a custom-tailored suit. "Excuse me, sir," you say politely, bringing him to a halt. "You look prosperous. Would you mind giving me six quarters to use this machine?"

Or how about this exchange? "Excuse me, sir. Do you own any Bank of America stock or mutual funds that hold their stock?" If he answers yes, you explain that because he made plenty of money last year, surely he can afford to share six quarters in a friendly gesture.

But why worry about whether he is a stockholder or even if he looks prosperous? Why should you have to pay to get money out? Just ask a random stranger for the six quarters. Wouldn't it be more pleasant to have someone else pay for your service?

When you frame the question in this way, it doesn't seem as plausible a request as making the banks reduce their profitability. Of course, "we" are the banks. Our fellow citizens who are the stockholders pay out of their pockets for a ban of ATM fees. Or the money comes from other customers or the employees in the form of lower wages. There is no free lunch.

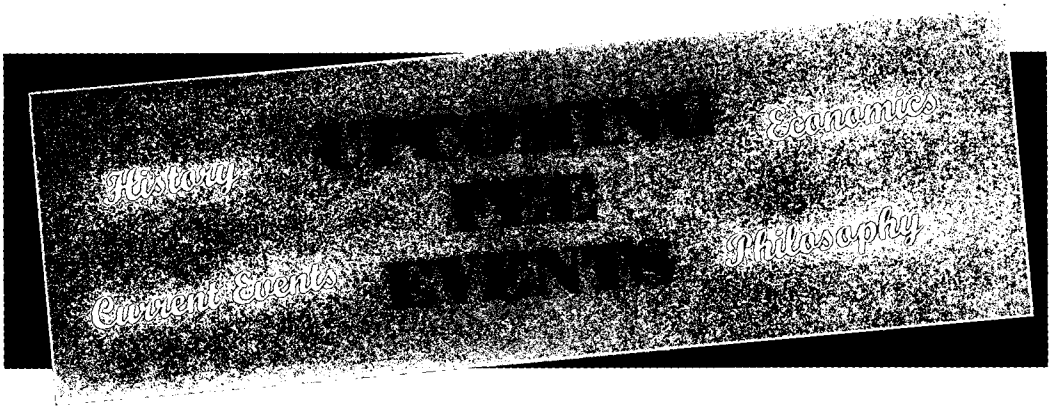
Recommended Response

All of the above is a bit lengthy for an effective radio interview. So here is my recommended speech for corporate interviewees when asked if they can afford to cut fees: "We'd love to cut fees. But unfortunately, there is no free lunch. We believe it would be immoral to make our customers, employees, or investors pay a price for serving the customers of other banks."

"But," interjects the interviewer, "don't you charge more than the actual cost? Don't you make a profit out of letting people get access to their own money?"

"Sometimes we do. That is the reward to our investors for taking the general risk of investing in a bank and for the specific risk of putting money in little machines that are prone to being robbed. Without that return, there would be no banks and you would keep your money under a mattress and sleep poorly. But look at the bright side of such a world. You would be able to take your money from under the mattress free of charge." □

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED



"New Directions in Economics"

May 25-28, 2000
Williamsburg, Virginia

An exciting program designed exclusively for undergraduate economics professors, this four-day seminar will focus on revitalizing the college classroom and finding ways to effectively convey economic concepts and theories.

Spring Undergraduate Seminar

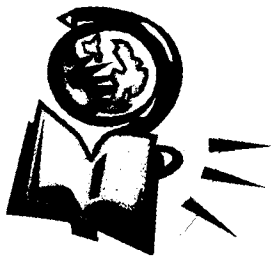
March 24-26, 2000
Irvington, New York

This intensive colloquium-style program invites students to FEE's New York headquarters to share ideas and to discover the economic and ethical advantages of a free society. Covering a variety of topics in economics, history, current events, and philosophy, this introductory seminar is a great opportunity for students to explore new ideas, meet people from around the globe, and just plain have fun.

To nominate a student, or for additional information and applications to these or other FEE programs, please contact Meredith Kapushion
mkapushion@fee.org

Foundation for Economic Education
30 South Broadway
Irvington-on-Hudson, NY 10533
914.591.7230
914.591.8910 (Fax)

To learn more, or to apply online visit www.fee.org!



LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

"We rail at trade, but the historian of the world will see that it was the principle of liberty; that it settled America, and destroyed feudalism, and made peace and keeps peace; that it will abolish slavery."

RALPH WALDO EMERSON (1803-1882),
entry written December 31, 1843, *Journals*

THE FOUNDATION FOR
ECONOMIC EDUCATION, INC.
30 South Broadway
Irvington-on-Hudson, NY 10533

Return service requested.

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED